Fresh To Go.

7-Eleven, Inc., 2003 Annual Report

At 7-Eleven, we are always taking a fresh look at convenience.

Leading this industry requires us to be forward-thinking, technologically adept and nimble. Consumer demands surface rapidly, and we strive for a fresh approach to business while preserving the brand customers have come to rely upon.

We are continually looking for fresh and innovative product offerings through market research, our retail information system and listening to our customers. We are committed to fresh ideas that will help grow the company. Our employees and franchisees complement these products and services by being focused on our customers. And, finally, we look for fresh ways to give back to and nurture our communities.

So whether you are in need of coffee and something to eat on the way to work or stopping for milk and a loaf of bread for dinner, 7-Eleven is focused on making convenience synonymous with "fresh."


So Chill
SLURPEE
28 oz. US

2003 Financial Highlights

Thanks to a fresh approach to delivering convenience, 7-Eleven, Inc. achieved total revenue growth of 10.1% and reported total revenue of $10.9 billion for 2003, a record for its convenience stores.

Six million customers a day visit our 5,784 stores in the United States and Canada, and they have come to expect an unmatched selection of fresh products, Slurpee® beverages, coffee, fountain drinks, and a number of other proprietary and convenience items.

Merchandise

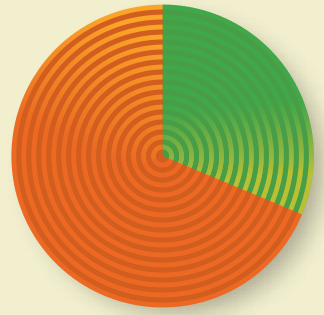
Responding to our customers' needs at each individual 7-Eleven® store through the use of proprietary technology is a key to our success. Scanning the globe for the freshest products and most convenient items and services keeps us on top of customer trends and has also contributed meaningfully to our growth in merchandise sales.

We continued our string of solid annual merchandise sales increases, reporting our tenth-straight yearly increase in 2003. Total merchandise sales increased $391.9 million, or 5.6%, over 2002, to $7.4 billion. Growth was primarily driven by a 3.2% increase in U.S. same-store merchandise sales, on top of a 3.1% increase for 2002. Significant contributors to the merchandise sales growth in 2003 were increases in the categories of cigarettes, non-carbonated beverages, beer, coffee and fresh food items.

Gasoline

Approximately 2,457 7-Eleven stores in the United States and Canada sell gasoline so customers can fuel up and purchase items like beverages and snacks at the same convenient time. The majority of gasoline stores offer pay-at-the-pump technology with 24-hour-a-day convenience.

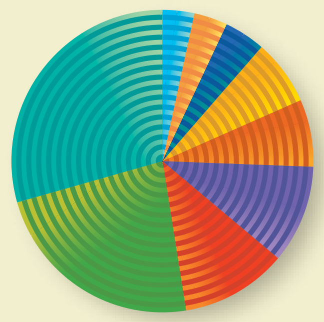
Our active daily monitoring and management of retail gasoline prices at individual 7-Eleven stores produced an eleventh consecutive year of strong gasoline margins. We delivered gasoline gross profit per gallon of 15.4 cents, for a total of $326.3 million. Total gasoline gallons rose 6.5% to 2.1 billion gallons. Gasoline sales increased by $611.7 million to $3.4 billion, or 22.2%, over 2002. Average per store gallon sales, a measure of year-over-year performance, increased 4.2%.



2003 Total Sales
(U.S. and Canada)

31.3% ($3.4 Billion)
Gasoline Sales

68.7% ($7.4 Billion)
Merchandise Sales



2003 Merchandise Sales
(U.S. and Canada)

3.4% **Services**

3.6% **Other**

4.4% **Dairy**

7.0% **Non-Foods**

7.2% **Fresh Foods**

10.5% **Candy/Snacks**

11.4% **Beer/Wine**

23.1% **Beverages**

29.4% **Tobacco**

Financial Highlights

(Dollars in millions, except earnings per share and store data)	2001	2002	2003
For the Year:			
Merchandise Sales[(1)(2)]	$ 6,672.1	$ 7,020.5	$ 7,412.4
Gasoline Sales[(1)]	2,636.6	2,760.6	3,372.3
Total Net Sales[(1)(2)]	9,308.7	9,781.1	10,784.7
Other Income[(1)]	111.9	102.9	97.0
Total Revenues[(1)(2)]	9,420.6	9,884.0	10,881.7
Core Earnings[(1)(3)]	104.7	76.8	88.8
Net Earnings[(4)]	83.7	12.8	64.1
Core Earnings Per Common Share (Diluted) [(1)(3)]	0.92	0.69	0.78
Net Earnings Per Common Share (Diluted)[(4)]	0.75	0.13	0.58
EBITDA[(5)]	483.0	413.1	498.3
Weighted Average Shares Outstanding (Diluted)[(6)]	125.9	111.5	127.2
At Year End:			
Shareholder's Equity	$ 152.5	$ 163.5	$ 340.0
U.S. Same-Store Merchandise Sales Increase[(2)]	2.8%	3.1%	3.2%
Gasoline Gallons[(1)]	1,813.6	1,987.3	2,117.0
Number of 7-Eleven Stores U.S and Canada	5,829	5,823	5,784
Total 7-Eleven Stores Worldwide	22,648	24,434	25,796
Total Sales in 7-Eleven Stores Worldwide[(2)]	$ 31,051	$ 32,651	$ 36,524

(1) Prior year amounts on the consolidated statements of earnings have been reclassified to discontinued operations to conform to the current year presentation in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

(2) Merchandise cost of goods sold amounts of $(136.4) million and $(155.5) million for the years ended December 31, 2001, and 2002, respectively, have been recorded as a reduction of merchandise sales to reflect our revised accounting for sales of prepaid phone cards net of related cost in conformity with the provisions of Emerging Issues Task Force No. 99-19, "Reporting Revenue Gross Versus Net."

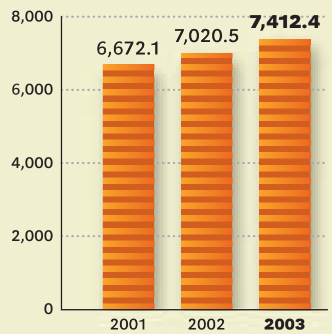
(3) Core earnings and core earnings per diluted share have been adjusted to exclude unusual items, cumulative accounting changes and discontinued operations.

(4) Net earnings in 2001 included an after-tax cumulative effect of accounting change of $(9.8) million in connection with the adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Net earnings in 2002 included an after-tax cumulative effect of accounting change of $(28.1) million in connection with the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations." Net earnings in 2003 includes an after-tax cumulative effect of accounting change of $(10.2) million in connection with the adoption of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51."

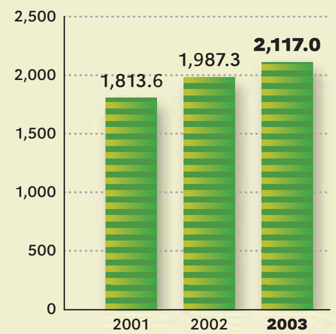
(5) EBITDA defined as earnings before net interest expense, income tax expense, depreciation and amortization, and cumulative accounting changes.

(6) In 2002 the shares in connection with the 1995 Convertible Quarterly Income Debt Securities were antidilutive to earnings per common share and were not assumed converted for weighted average shares outstanding.

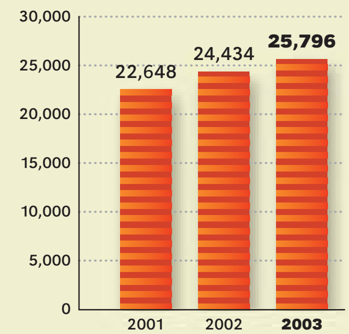
2003 U.S. and Canada Merchandise Sales
($ in Millions)



2003 U.S. and Canada Gasoline Gallons
(Gallons in Millions)



2003 Global Store Count
(As of Dec. 31, 2003)



Shareholder's Letter

James W. Keyes
President and Chief Executive Officer

Dear Fellow Shareholder:

Fresh ideas, fresh approaches and fresh products are all characteristics of the "new" 7-Eleven®. "Fresh" is the guiding principle that drives our company by helping us keep pace with the rapidly changing needs of convenience customers. We attribute the improvement in our performance to this obsession with freshness.

This focus on freshness, a sustainable competitive advantage, resulted in profitable growth in 2003. 7-Eleven, Inc.'s reported core earnings were $88.8 million, or $0.78 per diluted share, a 15.6% improvement over 2002. Revenue from our convenience store operations hit a record $10.9 billion and merchandise gross profit grew to $2.6 billion, an increase of 5.5%. One of the most gratifying achievements was the continued trend in our U.S. same-store merchandise sales, marking our tenth straight year of increases with a growth rate of 3.2% on top of a 3.1% rise the prior year. This continues our streak of 29 consecutive quarters of same-store merchandise growth.

Our profitable growth in 2003 can be attributed primarily to continued increases in same-store merchandise sales and improved gasoline gross profit. These items offset the one-time decrease in the royalty rate from Seven-Eleven Japan that resulted in an after-tax reduction of $14 million during the year. This was a long-anticipated change that actually occurred in mid 2002. Royalty income from licensed operations is expected to grow as Seven-Eleven Japan and our other licensees continue their growth.

Strong gasoline gross profit in 2003 contributed significantly to earnings. Total gasoline gallons sold climbed to 2.1 billion, or an increase of 6.5%. Gasoline gross profit was a healthy 15.4 cents per gallon and average per store gallon sales rose 4.2% contributing to a gross profit of $326.3 million. This marks the eleventh consecutive year of gasoline margins at or above 13 cents per–gallon. Day-to-day management of our gasoline business on a store-by-store basis is driving our steady performance, even in a year that saw rapid fluctuations in the price of gasoline.

25,000th 7-Eleven Store Celebrated
7-Eleven commemorated the opening of its 25,000th store in downtown Chicago.

Retailer Initiative keeps a fresh supply of products continually available.

With over 6 million daily customers in the U.S. and Canada, 7-Eleven's greatest opportunity is to do a better job of providing the products and services they want and need. Keeping pace with the changing need of convenience customers is at the heart of our unique strategy that we call Retailer Initiative. 7-Eleven's scale provides similar purchasing power and leverage as some of the world's greatest retailers. The infrastructure offers wide-ranging advantages from our proprietary retail information system to a nationwide network of daily distribution providers. Our Retailer Initiative strategy leverages both of these strengths as well as the entrepreneurialism of our individual store operators. Their

focus on item-by-item management—deleting slow-selling merchandise and introducing new items at every store, every day—allows 7-Eleven stores to satisfy their customers in ways that few retailers can match. In the simplest terms, we enjoy the power of a global retailer, but maintain the store-level focus of a single-store operator.

Technology has enabled this unique strategy. Our proprietary technology for inventory management captures even subtle shifts in buying patterns, allowing 7-Eleven stores to serve a diverse customer base. The easy-to-use system puts powerful decision-making tools in the hands of individual store operators. They can see what their customers are purchasing and which products are languishing so they can make informed decisions about precisely what to stock on any given day. We attribute the consistency and stability of 7-Eleven's sales over the past several years to our successful Retailer Initiative strategy.

To teach the principles and benefits of Retailer Initiative throughout 7-Eleven, we have established "model markets." To date there are nine model markets, representing around 600 stores. In these stores, store personnel undergo advanced training, use labor-saving equipment and practice effective merchandising techniques. In essence, they are reclaiming responsibility for ordering every item in the store, a responsibility that was long-ago delegated to suppliers. Today, 7-Eleven store managers and franchisees are armed with the most current and relevant information and make decisions far better than any individual supplier.

7-Eleven Convenience Card™
A faster, easier way to purchase goods at 7-Eleven stores was launched in 2003.

The model market initiative is already demonstrating benefits such as double-digit increases in sales, reduction in inventory, improvement in inventory turnover and a resulting improvement in store results. We anticipate further success as 7-Eleven continues to roll out the model market concept in 2004. While the first phase will be complete in 2005, our work will never be complete as we strive for continuous improvement in our ability to satisfy the customer.

Our commitment to product innovation offers customers fresh choices.

In addition to responding to today's buying patterns via Retailer Initiative, we tap into consumer trends to develop products they will buy tomorrow. During the year we introduced over 2,500 new items and deleted nearly as many slow-movers from our product assortment. A keen emphasis on proprietary products that provide differentiation, promote customer loyalty and typically offer a higher margin to the company are key elements of this merchandising strategy. 7-Eleven works closely with suppliers in an approach that we call Team Merchandising in order to collaborate on new product ideas.

One of our favorite examples is this past year's launch of Diet Pepsi–flavored Slurpee® beverage. Thanks to the diligence of our category management group and the product development team at PepsiCo, Inc., this long-awaited product was finally introduced last year. It generated a flood of positive media attention and, most important, a resounding response from

Our proprietary technology for inventory management captures even subtle shifts in buying patterns, allowing 7-Eleven stores to serve a diverse customer base. We call this successful strategy Retailer Initiative.

Fresh Food Test Market
Test marketing our fresh food products in 7-Eleven's Austin, Texas stores.

customers. Also a hit with customers was the lineup of Crystal Light sugar-free Slurpee® beverage flavors, and unique tastes like GraperMelon, which was created through our collaboration with the Wrigley Company.

Other proprietary products included the first-ever edible candy Slurpee® straw, novelty frozen products, energy drinks, enticing café combinations and tie-ins with hit movies. In response to consumers' increasing preference for premium import beer, we developed Santiago Cerveza de Oro™, made in El Salvador specifically for and sold exclusively by 7-Eleven stores.

Variety of Prepaid Wireless Phone Cards
7-Eleven is a premier loading destination for prepaid wireless services.

Existing product lines—favorites among our customers—have been expanded with fresh additions. 7-Eleven's Big Eats Deli™ sandwiches line offers more selections. The latest additions to our grill include a new line of Big Eats® griller sausages and a new Hot Pockets Brand Grill Snack program. A fresh food test market in Austin, Texas stores is underway to gauge consumer acceptance of products prior to a national rollout.

Another opportunity for proprietary product is 7-Eleven's growing lineup of services offerings. Last year we launched our stored value 7-Eleven Convenience Card™. During December—our most active month so far—our stores sold nearly 100,000 cards. Our findings show that customers think the card is easier to use than cash or credit, and they typically spend more when using this payment method.

Prepaid wireless phones and phone cards saw another strong sales year in 2003. 7-Eleven is already recognized as a premier loading destination for prepaid wireless services, and we have the opportunity to fortify this position even further.

Our streak of 29 consecutive quarters of same-store merchandise growth is due in part to our ongoing implementation of key initiatives and our commitment to introducing innovative products.

The initial rollout for Vcom®, our self-serve financial services kiosk, is complete. Last year 7-Eleven completed the installment of the machine in 1,000 stores, offering 24-hour access to a variety of financial transactions, including ATM, money orders, money transfers, check cashing and the ability to manage a Verizon online account.

7-Eleven is experiencing continued worldwide expansion.

Every day over 20 million customers visit our global network of nearly 26,000 7-Eleven stores. Our worldwide growth remains

All that we have achieved could not have been done without the commitment and involvement of our hard-working employees, franchisees and licensees.

strong with the addition of more than 1,300 licensed stores under the 7-Eleven sign in 2003. Seven-Eleven Japan opened its 10,000th store in August. Early in 2004, we were pleased to announce that the Ministry of Commerce in the People's Republic of China approved the formation of a joint venture among Seven-Eleven Japan, Co., Ltd., Beijing ShouLian Commercial Group Co., Ltd., and China National Sugar & Alcohol Group Corporation. Following the execution of an area license agreement with 7-Eleven, Inc., the joint venture will start to develop 7-Eleven stores in Beijing and the surrounding area. The first stores are expected to open in the spring of 2004.

All that we have achieved could not have been done without the commitment and involvement of our hard-working employees, franchisees and licensees. I personally want to thank them for their dedication to 7-Eleven and for their contribution to our improved results, especially our franchisees. As independent business people, they are seeing the mutual benefits of our strategy and continue to embrace and implement our initiatives.

Seven-Eleven Japan Opens 10,000th 7-Eleven Store
Seven-Eleven Japan reached this significant milestone in August 2003.

I believe 7-Eleven is the "Sign of Opportunity" for our employees, our franchisees, our licensees and for you, our shareholders.

This report will show you the energy and passion we bring to the task of improving our collective opportunities every day. I also hope it will help you share our confidence in the promising future before us. We have the opportunity to improve revenue and reduce cost through the increased efficiency of our infrastructure. The aggressive investment spending of the past few years is behind us and now one of our key challenges is to fully utilize the tools that are in place. We are confident in our ability to keep pace with the changing needs of customers by implementing our strategies to give customers what they want—exciting new products, fast service, easy transactions, quick in-and-out experiences and high quality, portable fresh foods—while providing our shareholders with steady, sustainable improvement in performance.

Sincerely,

James W. Keyes
President and Chief Executive Officer

Technology helps us give customers the fresh products they expect.

Customers rely on 7-Eleven to deliver consistent, reliable products day in and day out. Behind the scenes we use advanced technology to ensure that these top-selling items are always in stock and our assortment of fresh foods is continuously available.

Our retail information system is a tool that provides store operators historical sales data and key indicators of sales for any item, such as the time of day it was sold, the package size and product flavor. This empowers them to customize their product mix according to customers' purchases, emerging trends, season, demographic preferences and even specific product requests.

Through this process of Retailer Initiative, 7-Eleven improves the productivity of stores and the profitability of our company.

Here's an example.

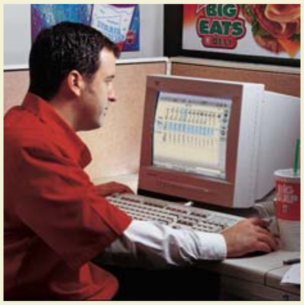
The past few years we noted increasing sales of nutritional items like energy bars and beverages, and saw a growing trend in high-protein/low-carbohydrate diets. It was an early sign that many consumers were becoming more keenly focused on food that would not conflict with their new eating habits. We worked with vendors to develop low-carb choices such as energy bars and snack chips. These diet-friendly items are merchandised throughout the store and clearly marked. 7-Eleven also gained exclusivity in the convenience channel for Mad Croc Energy Drink. This beverage introduction was one of the most successful in 2003, matching other high-profile energy drink sales and bringing new users to the category. Most important, this energy drink offers customers a lower-priced option for a high-quality product and provides the company with a higher profit margin than similar products.

Technology gives us the ability to try new products—in selected stores or nationally—with a great deal of confidence and little risk. We can stock an item on a Monday, know how customers are responding the next day and decide quickly if it's a success.

Continued investment in technology helps build on our success.

7-Eleven continued to enhance its technology capabilities during 2003, further sharing the power of information throughout the enterprise. We upgraded store infrastructures to allow for individual computer-based training, and added a number of features to the retail information system that simplified operations, such as a real-time ability to change prices at the gasoline pumps, electronic signature capture for credit and debit cards, and an easier process for identifying new products available to the stores.

During the year we also improved efficiency and performance throughout the organization. The 7-Connect intranet portal facilitates communication among stores in nearly 6,000 locations. Our field organization now has better analysis and reporting capabilities. Several previously manual functions in our accounting, procurement and human relations departments are now automated. And our data warehouse improves the organization's ability to access and analyze information.



While technology enables our Retailer Initiative strategy and other critical operations throughout the company, it is our people who use it. Our retailers' eagerness to apply this new technology makes their job of giving customers what they want easier and more effective. This winning combination made possible 7-Eleven's sixth consecutive year of U.S. same-store merchandise sales in the three- to five-percent range and a 3.2% increase in U.S. same-store merchandise sales for 2003. Continuing to achieve these trends is our mission. It's based on harnessing the power of fresh data. ■

Delivered fresh, every morning.

Determining what customers want is only the beginning. Getting this broad selection of quality products to our stores in a timely manner is also critical. That's where 7-Eleven enjoys a true point of differentiation.

Every day 7-Eleven stores electronically send delivery orders to the commissaries and bakeries that produce our signature line of fresh food products. Items are prepared fresh the same day—adhering to 7-Eleven's proprietary recipes and strict specifications. Fresh products are date- and time-stamped. Other perishable products are delivered throughout the day to

Fresh Daily.

the distribution center to be sorted for that night's delivery. 7-Eleven's combined distribution center (CDC) concept "combines" these products from multiple suppliers for daily delivery by third-party logistic operators. As a complement to the twice-weekly traditional distribution method for dry goods, the CDCs deliver fresh items such as our proprietary line of Big Eats Deli™ sandwiches, Big Eats Bakery® fresh bakery products, dairy products, bread, produce and other perishable items to 7-Eleven stores 365 days a year.

Strategically located throughout North America, 23 CDCs support approximately 4,700 stores, or just above 80% of the store network. Daily distribution provides many advantages to 7-Eleven, among them are the ability to deliver fresh, high-quality products, reduce the sheer number of deliveries to any given store, lower distribution costs, free-up parking spaces for customers and generally increase the amount of time store operators can devote to customer service. The CDC also enables stores to carry products from regional or local manufacturers, creating true customization at the store level.

With daily ordering and delivery, a store can replenish stock of its more popular items within hours rather than days, shortening the amount of time between order and delivery. The ability to order more efficiently and better manage inventory is part of the reason 7-Eleven has achieved its sixth-straight yearly increase in inventory turnover.

CDCs completed around 1.7 million fresh food deliveries in 2003 to 7-Eleven stores, increasing the volume of goods delivered daily while maintaining service standards and reducing distribution costs. This contributed to total fresh food sales in 2003 exceeding $450 million, or an increase of just over 11%.

While managing how product gets to our stores is challenging, we are making progress. Increasing frequency from once a day to twice a day in some locations will further derive benefits from the system. We challenge suppliers that deliver directly to our stores to do so more frequently and at a time that minimizes disturbance. All of these efforts are designed with our customers in mind—delivering value by offering fresher products, greater variety and added convenience.■

New approaches to marketing fresh food.

The iconic 7-Eleven® logo and red, orange and green stripes winding around suburban-area stores is a powerful image. Regular customers know they can dash in and purchase quality, fresh products in a clean and friendly atmosphere. While this remains a constant, we've refreshed our thinking about some aspects of our store locations, size and appearance to bring 7-Eleven stores to once untapped markets.

Many of these target consumers are on foot—walk-up customers in city centers, university campuses, airports and other high-density areas—and want a fresh selection of foods and beverages as well as convenience items. Our urban store format is consequently smaller, requires less capital investment, can be opened more quickly and utilizes the existing distribution infrastructure. Retailer Initiative is integral to its operation, directing retailers what to stock and having fresh product available daily.

Deli and breakfast sandwiches, meals hot off the grill and fresh-baked donuts, muffins and cookies are a sampling of this fresh food. We are making it the focus in our 7-Eleven stores in Austin, Texas, where we have designed and are testing a fresh food section featuring our freshest, best-tasting and highest-quality products.

Fresh thinking also pays dividends in package design and adds to a product's appeal. We recognized a rise in the number of people who snack while in their cars, so we are working with companies to create packages that fit their lifestyle. Cookies, chips and candy are now available in containers that fit into cup-holders instead of bags. Dozens of items are available this way, including many of our own.

We are continuing to develop other ways to grow fresh food sales, and making it a major goal for 2004 and beyond.

Something new in store.

Some of the best ideas come from our employees, franchisees and vendors who have joined us in making a success of the concept we call Team Merchandising. At its essence, Team Merchandising is designed to find ways to meet consumer demands, even if it challenges conventional assumptions. The results are as complex as a technology that bundles financial services, as ordinary as equipment that enhances product quality and as innovative as exclusive product offerings.

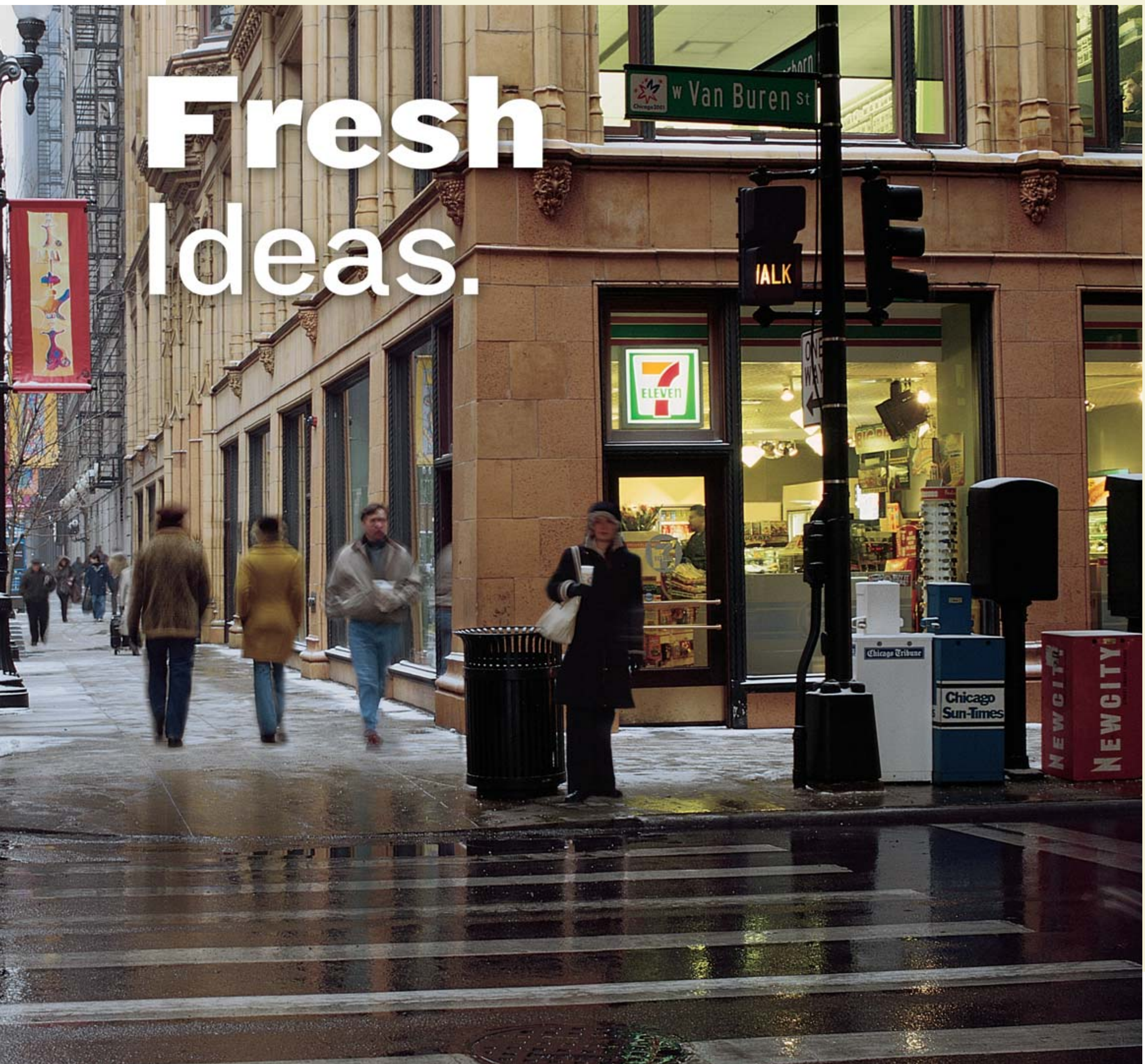
Vcom®, which stands for "virtual commerce," is 7-Eleven's proprietary financial services kiosk. Its initial rollout was completed last year and it is now available in 1,000 stores in 25 markets. With the ease of a touch-screen and convenience of 24-hour availability, Vcom offers ATM, check cashing, money order purchases and money transfers, and access to Verizon residential telephone services. Last year, we saw steady growth in the number of new Vcom members and services transacted. We are optimistic about continued improvement in 2004 as we prepare to offer bill payment, phone cards, stored value cards and lottery sales. We will continue to add more functionality to provide customers with a one-stop shop for their financial services needs.

Also new in our stores is an upgraded hot beverage bar. We installed around 4,300 cappuccino/cocoa machines in late 2003. Several enticing flavors like Oreo Mint, Candy Cane and Hershey's S'mores candy bar were introduced alongside our top-selling French Vanilla Cappuccino. Supporting this rollout was a successful "1300+ Ways to Create Your Own Coffee™" advertising campaign which received great customer response. Fresh flavors will continue to be added throughout 2004.

Stirring up conventional thinking often leads us to completely different product categories. We began testing disposable DVDs. This novel twist to DVD movie rental will allow us to offer customers choices without heavy inventory costs.

Challenging ourselves to take a fresh look at our products and consumers' needs will lead us to innovative products, new options and additional markets as we continue to break ground in the industry.

Fresh Ideas.



Changing products to give customers greater choice.

When customers walk into a 7-Eleven store on any given day, they're sure to find what they need as well as something new. We are continually changing our product selection in order to anticipate what customers want, then give them a product that is even better than expected. This strategy requires us to stay alert to developing trends in the marketplace, and be prepared to test and introduce products that address those trends. Doing so early in the product's life cycle allows us to fully tap its potential.

Last year 7-Eleven introduced more than 2,500 new items—around 50 a week—and their popularity among customers was evident in our steady rise in sales. Our company marked its tenth-straight increase in annual U.S. same-store merchandise sales, and, as of fourth quarter 2003, 29 consecutive quarterly increases. This continued steady growth produced a 5.6% increase in total merchandise sales for 2003, with merchandise sales reported at $7.4 billion.

Sharing this success with suppliers, who appreciate and share our passion for product innovation, creates a winning combination of resources. Team Merchandising enables us to offer products that are superior to what could be accomplished alone. Last summer 7-Eleven held its first-ever strategic review and planning session with representatives from more than 100 of our major suppliers. This gave us the opportunity to develop new relationships and strengthen established ones.

A notable outcome of Team Merchandising was the expansion of 7-Eleven's Slurpee beverage choices. We tapped into the low-calorie/low-carbohydrate trend and met customers' demand for great-tasting refreshment with popular sugar-free Crystal Light Raspberry Ice, Lemon-Lime and Orange-Pineapple flavors. And we reached a hard-fought goal with the launch of Diet Pepsi Slurpee. After years of working to overcome technical challenges, PepsiCo created the perfect blend of nonnutritive sweeteners and other ingredients to produce the first-ever zero-calorie Slurpee drink. With these beverages, 7-Eleven added recognizable names to its list of proprietary brands.

Our determination to develop additional low-calorie products will continue because our customers are becoming more health-conscious and want their options at 7-Eleven to include a greater variety of good-for-you products. Recognition of this customer need led us to seek or develop dozens of low-carbohydrate, high-nutrition food products that were introduced throughout 2003. Expect to see other Team Merchandising breakthrough products in 2004.

7-Eleven's other new items included merchandise tie-ins with hit movies; Slurpee-licensed candy, straws and gum; proprietary café combinations at the coffee bar; exciting

Fresh Assortment.

cappuccino flavors; the melt-in-your-mouth Dreammm Donut; an appetizing selection of new 7-Eleven Go-Go Taquitos® and tasty fresh sandwiches at our Big Eats Deli open air case.

This parade of new products is the result of keeping our focus on our customers and delivering what they have come to expect from 7-Eleven—fresh ideas, a fresh look and fresh product.

Moving the inventory.

One of the priorities of store operators and their associates is ordering properly. It is the responsibility of each store to be in stock on fast-selling items, appropriately merchandising high-potential products and removing slow-selling ones in order to make space for continual new product introductions.

Inventory turnover tells us how quickly and broadly we are selling our products, and turning inventory faster is pivotal to our success. 7-Eleven's merchandise inventory turnover rate was more than 17 times in 2003 and our near-term goal is to reach 25 turns. That's where the fresh thinking empowered by Retailer Initiative helps master inventory. We manage every item, in every store, every day, stocking those products that sell and eliminating those that don't.

Always having available, exciting, fresh products customers want—sometimes even before they know they want it—is an unbeatable combination.■

Developing great people to build great stores.

The success of 7-Eleven as an enterprise is based on the hard work of its employees, franchisees and licensees. To assist the front-line staff in managing an effective store, we launched an intense 12-week certification program in 2002 and stepped up the pace of training in 2003. Almost one-third of the field management organization was certified by the end of 2003.

We have made it easier for people working in the stores to learn while on the job with Web-enabled computer-based training. This better facilitates communication with corporate areas as well.

To achieve better order forecasting, we created a two-day advanced classroom training module that has been completed by more than 2,700 store sales associates. These training tools are intended to apply our Retailer Initiative strategy at a higher level, continuing to support our merchandise sales growth and better manage inventory.

Early results indicate that what we are doing is working. Improved hiring, career path development and better training have lowered store-associate turnover two years in a row, or a decrease from 2001 of almost 20%. Customer service scores—a measurement of our five fundamental principles of Assortment, Quality, Value, Cleanliness and Service at the store level—have improved again in 2003, and we expect greater strides in 2004.

Better alignment with franchisees.

Franchisees operate around 3,300 7-Eleven stores in the United States and are an integral part of the company's success. This entrepreneurial group delivered another solid year in 2003.

Further aligning 7-Eleven's interests and its franchisees is a new franchise agreement developed together over the last two years. This agreement combines 7-Eleven's strategies regarding fresh foods, combined distribution, and differentiation with franchisees' entrepreneurial business approach. In addition, the new agreement should enhance the company's ability to leverage its scale with additional purchasing power and reduce costs to the stores. By strengthening the relationship with our franchisees, we should improve profitability for both franchisees and 7-Eleven.

Working as a team generates fresh ideas.

The success of Team Merchandising and Retailer Initiative is an orchestrated effort by 7-Eleven, its people and its suppliers. Last year proved to be productive, with our introduction of 2,500 new products and the expectation for even more in 2004.

A few of our suppliers are worthy of particular mention, for they embody the qualities of mutual dedication and commitment to excellence necessary to produce winning results through Retailer Initiative. The Retailer Initiative Award recipients were Nestlé Waters North America, Inc. taking top honors, with special honorees The Foreign Candy Company, Inc. and AT&T Wireless.

7-ELEVEN
CUSTOMER SATISFACTION
FIRST, BEST AND ONLY
TEAM MERCHANDISING
DEMAND CHAIN EFFORTS

Good companies make good neighbors.

Our employees and franchisees have a history of active participation in their communities through community service days, local government and community boards. We applaud their dedication.

7-Eleven supports worthy charities through direct donations, in-kind contributions and its signature canister program. Last year our canisters raised nearly $1 million for national charities like the American Red Cross, Muscular Dystrophy Association and Education is Freedom. 7-Eleven and its franchisees have raised a total of $100 million since 1976, the program's inaugural year.

7-Eleven donated to local programs supporting a variety of causes like education, the arts, law enforcement and food banks. Through customer donations and corporate giving, 7-Eleven donated nearly $3 million in support during 2003 to nonprofit organizations in the communities we serve.

7-Eleven was the recipient of several awards in 2003. Some of those honors included recognition as a Top 100 Franchise by *Nation's Restaurant News*, *Hispanic* magazine's Corporate 100 List and for the thirteenth-straight year ranked by *Entrepreneur* magazine in Top 500 Companies to Franchise, taking 4th place in 2003. Additionally, the company received a number-one ranking in every category of the 2003 *Convenience Store News* annual study, inclusion in the new business book *America's Greatest Brands*, named as *Beverage Aisle* magazine's "Retailer of the Year," "Retail Leader of the Year" from *CSP* magazine and some notable technology awards from *Infoworld*, *Computerworld* and *CIO* magazines.■

7-Eleven's story is as fresh and familiar as a steaming cup of coffee.

Thanks to our fresh thinking, fresh products and fresh methods of delivering convenience, 7-Eleven® is a well-recognized global brand. Every day approximately 26,000 stores in 18 countries and territories serve some 20 million people.

Responding to customers' needs at the store level is vital to our success. We scan the globe for the most convenient and freshest products. Products that are on-target with customer trends and that can contribute significantly to our continued success in merchandise retailing.

Reaching new customers plays a role in reaching our sales goals as well. We developed a concept for a walk-up urban store that serves customers in city centers, on university campuses, at airports, apartment buildings and other highly populated areas.

Ongoing investment in technology and our people has empowered our individual store retailers and streamlined our inventory management. Our company's ongoing commitment to developing leaders ensures that these products and programs are successfully implemented and managed.

Last year was one of growth, forward momentum and innovation. We reaped the rewards of our hard work and learned what we need to do to continue our progress. 7-Eleven is well positioned to set even more sales records. Our first store embraced the fresh approach of selling much-needed food items on Sunday, and that innovation stays with us today as the new 7-Eleven continues to evolve.■

Financial Review

Selected Financial Data

Years Ended December 31	1999	2000	2001	2002	2003
(Dollars in millions, except per-share data)			*(Restated)*	*(Restated)*	
STATEMENT OF EARNINGS DATA:(1)					
Net sales:					
Merchandise(2)	$6,014.6	$6,427.5	$6,672.1	$7,020.5	$ 7,412.4
Gasoline	1,927.6	2,580.7	2,636.6	2,760.6	3,372.3
Total net sales(2)	7,942.2	9,008.2	9,308.7	9,781.1	10,784.7
Other income	97.5	104.4	111.9	102.9	97.0
Total revenues(2)	8,039.7	9,112.6	9,420.6	9,884.0	10,881.7
LIFO charge (credit)	9.9	4.6	(7.5)	10.3	0.3
Depreciation and amortization(3)	205.5	219.2	246.8	279.8	306.9
Interest expense, net	102.2	79.3	62.7	64.7	71.3
Earnings from continuing operations before income taxes and cumulative effect of accounting change(4)	130.0	156.8	167.1	102.4	141.0
Income tax expense(5)	(49.6)	(48.4)	(65.2)	(41.0)	(53.6)
Earnings from continuing operations before cumulative effect of accounting change	80.4	108.4	101.9	61.4	87.4
Gain (Loss) on discontinued operations	2.7	(0.1)	(8.4)	(20.5)	(13.1)
Cumulative effect of accounting change(6)	—	—	(9.8)	(28.1)	(10.2)
Net earnings	83.1	108.3	83.7	12.8	64.1
Earnings from continuing operations before cumulative effect per common share:					
Basic	0.98	1.08	0.97	0.59	0.82
Diluted	0.78	0.89	0.90	0.56	0.76
Weighted-average shares outstanding:					
Basic(7)	82.0	100.0	104.8	104.8	106.8
Diluted(7)(8)	103.0	121.4	125.9	111.5	127.2
BALANCE SHEET DATA (end of period):					
Total assets	2,685.7	2,742.3	2,902.8	3,064.3	3,348.9
Total debt	2,044.7	1,337.5	1,434.6	1,415.2	1,475.3
Convertible Quarterly Income Debt Securities(9)	380.0	380.0	380.0	380.0	300.0
Total shareholders' equity (deficit)(7)	(559.6)	82.1	152.5	163.5	340.0

(1) Prior-year amounts on the Statement of Earnings Data have been reclassified to discontinued operations to conform to the current-year presentation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

(2) Merchandise cost of goods sold amounts of $(136.4) million and $(155.5) million for the years ended December 31, 2001 and 2002, respectively, have been recorded as a reduction of merchandise sales to reflect our revised accounting for sales of prepaid phone cards net of related costs in conformity with the provisions of Emerging Issues Task Force No. 99-19, "Reporting Revenue Gross Versus Net."

(3) We adopted SFAS No. 142, "Accounting for Goodwill and Other Intangible Assets," effective January 1, 2002. In connection with adopting SFAS No. 142, we no longer amortize goodwill or intangible assets with indefinite lives. Amortization of these assets in 1999, 2000 and 2001 was $19.6 million, $19.7 million and $19.8 million, respectively.

(4) Earnings from continuing operations before income taxes and cumulative effect of accounting change in 1999, 2000 and 2003 include gains of $7.0 million, $2.9 million and $10.5 million, respectively, in connection with debt redemption.

(5) Income tax expense in 2000 includes a $12.5 million benefit in connection with our settlement of certain outstanding issues with the IRS.

(6) In 2001, we adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities;" in 2002 we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations;" and in 2003 we adopted FASB Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51."

(7) In the first quarter of 2000, we issued 22,736,842 shares of common stock at $23.75 per share to IYG Holding Company in a private placement transaction. In the third quarter of 2003, we issued 6,501,685 shares of common stock to IY and SEJ from the conversion of the 1998 Convertible Quarterly Income Debt Securities (see Note 10).

(8) In 2002, the shares in connection with the 1995 Convertible Quarterly Income Debt Securities were antidilutive on earnings per common share and were not assumed converted for weighted-average shares outstanding.

(9) In 2003, the 1998 Convertible Quarterly Income Debt Securities were converted into 6,501,685 shares of common stock. The 1995 Convertible Quarterly Income Debt Securities have an interest rate of 4.5% and are potentially convertible into a maximum of 14,422,383 shares of common stock.

Management's Discussion and Analysis of Financial Condition and Results of Operations

This report includes certain statements that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Any statement in this report that is not a statement of historical fact may be deemed to be a forward-looking statement. We often use these types of statements when discussing our plans and strategies, our anticipation of revenues from designated markets and statements regarding the development of our businesses, the markets for our services and products, our anticipated capital expenditures, operations, support systems, changes in regulatory requirements and other statements contained in this report regarding matters that are not historical facts. When used in this report, the words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and other similar expressions are generally intended to identify forward-looking statements. Because these forward-looking statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements. There can be no assurance that: (i) we have correctly measured or identified all of the factors affecting us or the extent of their likely impact; (ii) the publicly available information with respect to these factors on which our analysis is based is complete or accurate; (iii) our analysis is correct; or (iv) our strategy, which is based in part on this analysis, will be successful. We do not assume any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

7-Eleven, Inc. is the world's largest operator, franchisor and licensor of convenience stores with nearly 26,000 stores worldwide. 7-Eleven derives its revenues principally from retail sales of merchandise and gasoline from Company- and franchisee-operated stores. We also receive income from monthly royalties based on sales of licensed stores, which are predominantly international. Our primary expenses consist of cost of goods; franchisee gross profit expense; operating, selling, general and administrative expense; interest expense and income taxes.

7-Eleven sells a broad selection of merchandise items. In addition, we sell gasoline at approximately 40% of our stores. Sales of merchandise during the last three years have generated around 70% of 7-Eleven's revenue, and approximately 90% of our gross profits. Gross profit margins for merchandise have averaged approximately 35% during the last three years, while gasoline has averaged approximately 10% during the same period.

We seek to meet the needs of convenience customers and maintain a leadership position in the convenience store industry through leveraging our scale, technology, people and widely recognized brand. In 2004, we will continue to focus on the implementation of our key growth initiatives to improve the operating performance of our Company.

Merchandise Retailing

In an effort to meet the changing needs of our customer base, we offer a broad range of products, including many not traditionally available in convenience stores. These products range from high-quality fresh foods delivered daily to unique items that are developed specifically for 7-Eleven.

Working with outside vendors, 7-Eleven's merchandising team continuously focuses on developing and introducing new products in order to increase overall merchandise sales. We strive for exclusivity from suppliers on these items either for a limited or an extended period to gain a competitive advantage in the convenience channel.

Our decision to add a higher-quality, freshly prepared sandwich and bakery line, additional roller grill products and new salads reflects our strategy to promote proprietary fresh food products to increase sales. During 2003, we established a testing center in our Austin, Texas stores to gauge consumer tastes regarding fresh food products prior to a national rollout. In 2004, much of the Company's radio and television advertising and point-of-purchase displays will focus primarily on fresh food products. We believe that the Company is well-positioned to take advantage of growth in portable fresh foods and that this category will be a key contributor to our long-term growth.

We developed a proprietary retail information system that enables our merchandising team, franchisees and store managers to increase sales by enhancing the product mix in each store. By employing item-by-item inventory management, stores are better equipped to remain in-stock on top-selling items, as well as promote new high-potential items. Franchisees and store managers are expected to monitor customer buying patterns in their stores to try to maximize their sales through the management of their product assortment. This strategy, which we call Retailer Initiative, has contributed to our sustained ability to grow merchandise sales.

Growing the services category continues to be one of our priorities. Among the products in the services category are prepaid cards, lottery sales, ATM services, and money orders. Additionally, we offer Vcom® units in approximately 1,000 stores. Vcom is our proprietary self-service kiosk through which we provide continuously available financial and e-commerce services. Available 24 hours a day, Vcom offers check-cashing, money orders, money transfer, traditional ATM services and access to Verizon residential telephone services. We expect to provide additional services, such as phone cards, bill pay, and proprietary stored value cards in

2004. We are using market research studies and focus groups to make Vcom even more user-friendly. We have seen continued steady transaction growth in the core financial services products since the rollout was completed in the middle of 2003. We expect the recent positive trends in the number of transactions will continue in 2004 as we further refine our Vcom strategy.

Gasoline

We believe that gasoline sales contribute to increased store traffic. As a result, we offer gasoline as a convenient product for customers wherever practical. Our gasoline strategy is to be competitively priced to maximize gross profit. Over the last 10 years, we have consistently achieved at or above a 13 cent-per-gallon level of gasoline gross profit margin. Day-to-day management of our gasoline business on a store-by-store basis is driving this steady performance, even in a year like 2003 that saw rapid fluctuations in the price of gasoline.

Store Base

7-Eleven is working to optimize the earnings of its store base by opening new stores in strategic locations and closing underperforming stores. We plan to open approximately 100 stores in 2004. Our new store development efforts are focused on our existing markets to take advantage of population density and leverage our current distribution capabilities. We assess new store locations by evaluating demographics, traffic volume, visibility, ease of access, economic activity and population density in the area.

We continue to focus on either improving or closing underperforming stores and have developed a database to track and analyze performance. In addition, we have created a more structured new site approval process and added a site development management system. These enhancements are designed to identify the cause of underperformance and to maximize future performance.

During 2004, we intend to continue to upgrade our more mature stores with around $80 million of capital spending related to maintenance and replacement of store equipment.

Technology

Our retail information system provides franchisees, store managers and our management team with timely access to sales information on an item-by-item basis. Details are captured by a point-of-sale scanning system at the checkout register. Stores are linked to vendors, our primary third-party distributor and our combined distribution centers for ordering and item-level information sharing. Effective use of the system is one of the foundations of our business model, allowing franchisees and store managers the ability to manage both their products and time more effectively.

We spent $81 million on technology in 2003. The majority of the spending was for enhancements to our retail information system, store process improvements and increased efficiency measures. During 2003, we introduced improved functionality such as additional alternative payment methodologies, enhancements for ordering and additional support for managing product assortment. These actions were designed to give store managers more time to run their stores. To facilitate better communications across the organization, we launched an intranet information-packed homepage, upgraded our field consultants' laptops and enabled expanded computer-based training at the store. During 2004 and 2005, we plan on completing an initiative to upgrade our store systems hardware and the software architecture to a more flexible platform.

Employees and Franchisees

Employees and franchisees are critical to implementing 7-Eleven's strategies. We continue to invest in finding and retaining qualified people through focused recruitment efforts, establishment of formal career paths and leadership development programs. Additionally, we are trying to raise the level of performance of our people with advanced training and incentive programs. We recently implemented new training certification curricula for our field organization and store level employees. During 2003, we accelerated the pace of training with almost one-third of the field support organization completing our "certification" process. Overall, our effort to upgrade the effectiveness of our store associates has resulted in a two-year reduction in store-level employee turnover.

We introduced an incentive program that links store performance measurements with 7-Eleven's fundamental business concepts. Grading and rewarding the successful execution of the Five Fundamentals – Assortment, Quality, Value, Cleanliness and Service – has gradually improved store ratings over the last two years. We expect continued improvement in 2004 and beyond.

The primary method of implementing our Retailer Initiative strategy across our store network is through the establishment of "model markets." A model market is comprised of a group of stores where we are employing advanced training, labor-saving equipment, and a concentrated focus on merchandising to enable store operators to optimize their product assortment. The model market rollout will accelerate throughout 2004 and we expect to have the program rolled out in all of our markets by the end of 2005. We anticipate that it will take between 12 and 18 months to complete the rollout of the model market program. The early results are promising.

Management's Discussion and Analysis of Financial Condition and Results of Operations

To further align 7-Eleven's interests with those of our franchisees, over the past two years we have worked with our franchisees to develop a new franchise agreement. This agreement combines 7-Eleven's strategies regarding fresh foods, combined distribution, and differentiation with franchisees' entrepreneurial business approach. In addition, the new agreement should enhance the Company's ability to leverage its scale with additional purchasing power and reduce costs to the stores. By strengthening the relationship with our franchisees, we should improve profitability for both franchisees and 7-Eleven. To find the best candidates to implement 7-Eleven's business model, we are developing a new selection process for franchise candidates. We believe this will better ensure successful execution of the Company's strategy to increase profitability.

Trademark

We look to increase the value of our licenses by continuing to develop our infrastructure and offering a more attractive financial opportunity to prospective licensees. The majority of our licensees are international, and our long-range plans are to expand the 7-Eleven brand into a number of countries where we currently do not have a presence. As we have previously disclosed, we are exploring additional licensing arrangements in China. In early 2004, we announced the approval of a joint venture by the Ministry of Commerce in the People's Republic of China to develop 7-Eleven stores in Beijing and the surrounding area with the first stores expected to open in the spring of 2004.

Critical Accounting Policies and Estimates

Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The results of these estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions. See Note 1 to the Consolidated Financial Statements.

Franchisees

We consolidate all merchandise sales and cost of goods sold from stores operated by franchisees with the results of company-operated stores. We split the merchandise gross profit of franchise stores between our franchisees, who have been generally receiving 48% of the gross profit, and ourselves. During 2004, we are beginning to franchise our stores under a new franchise agreement. The split of the gross profits between the franchisee and us under the new agreement will generally be 50/50. Our share of the merchandise gross profit of franchise stores represents the ongoing royalty. With regard to gasoline sales, our traditional franchise agreements in most instances require us to pay the franchisee one cent per gallon sold as compensation for the services our franchisees perform related to gasoline. We have implemented a non-contractual policy under which we pay our franchisees the greater of (i) 1.5 cents per gallon or (ii) either 20%, 24% or 25% of the gasoline gross profit, depending upon when the store was franchised. We can change this policy at any time but have agreed to keep the policy in place for all of 2004. The franchisees' share of the merchandise and gasoline gross profit is presented as franchisee gross profit expense in the accompanying Consolidated Statements of Earnings. If we did not consolidate the franchisee merchandise revenues and cost of goods sold into our consolidated financial results, our net earnings would not change; our Consolidated Statements of Earnings, however, would not reflect any franchise gross profit expense and would reflect significantly lower merchandise revenues and cost of goods sold. Instead, our share of the earnings from franchised stores would be reflected as Other Income in our Consolidated Statements of Earnings. See "– Other Issues – Franchise Agreement Renewal."

We include the franchise stores' merchandise sales and cost of sales in our financial statements because we believe that we retain a more significant financial and merchandising advisory role in the franchise business than is present in most other franchisor/franchisee relationships. For example, unlike most franchise models, we own or lease the stores and equipment used by the franchisees as well as provide financing, bookkeeping, advertising, business consulting and other services. Due to this level of involvement and our retention of certain business risks associated with the ownership or leasing of franchised locations and the equipment used by franchisees, we believe that our financial statement presentation appropriately reflects the substance of this combined economic relationship. See Note 1 to the Consolidated Financial Statements.

We are currently analyzing Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" ("FIN 46"), and its impact on our accounting for the franchisees. See Notes 1 and 19 to the Consolidated Financial Statements.

Environmental

We accrue for the estimated future costs related to remediation activities at existing and previously operated gasoline storage sites and other operating and nonoperating properties where releases of regulated substances have been detected. Our estimates of the anticipated future costs for remediation activities at such sites are based on our prior experience with remediation sites. In addition, we consider factors such as the condition of the site contamination, location of tank sites and our experience with contractors who perform environmental assessment and remediation work. We determine the reserve on a site-by-site basis and record a liability for remediation activities when it is probable that corrective action will be taken and the cost of the remediation activities can be reasonably estimated.

A portion of the environmental expenditures we incur for remediation activities is eligible for reimbursement under state trust funds and reimbursement programs. We record a receivable for estimated probable refunds at the same time that we record the liability. The amount of the receivable is based on our historical collection experience with the specific state fund (or other state funds), the financial status of the state fund and our priority ranking for reimbursement from the state fund. We discount the receivable if the amount relates to remediation activities that have already been completed.

The estimated future remediation expenditures and related state reimbursement amounts could change within the near future as governmental requirements and state reimbursement programs continue to be implemented or revised. Such revisions could have a material impact on our operations and financial position. See "– Other Issues – Environmental" and Note 14 to the Consolidated Financial Statements.

Store Closings and Asset Impairment

The results of operations of certain owned and leased stores are presented as discontinued operations in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Since 2002, the results of operations of owned stores have been presented as discontinued operations beginning in the quarter in which management commits to a plan to close the related store and actively markets the store. The results of operations of a leased store are presented as discontinued operations beginning in the quarter in which the related store ceases operations. The results of operations of these owned and leased stores include related write-downs of stores to estimated net realizable value and accruals for future estimated rent and other expenses in excess of estimated sublease rental income.

We write-down property and equipment of stores we are closing to estimated net realizable value at the time we commit to a plan to close such stores and begin to actively market the store. If we lease the store, we accrue for related future estimated rent and other expenses if we believe the expenses will exceed estimated sublease rental income. We adopted the provisions of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," and as a result, effective January 1, 2003, if we lease the store, we will accrue for related future estimated rent and other expenses at the time the store ceases operation if we believe the expenses will exceed estimated sublease rental income. Prior to 2003, we accrued for related future estimated rent and other expenses when we committed to a plan to close the stores. We base the estimated net realizable value of property and equipment on our experience in utilizing and/or disposing of similar assets and on estimates provided by our own and/or third-party real estate experts. We also use our experience in subleasing similar property to estimate future sublease income. If there is a significant change in the real estate market, our net realizable value estimates and/or our estimated future sublease income could change materially. See "– Other Issues – Recently Issued Accounting Standards" and Notes 1 and 5 to the Consolidated Financial Statements.

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," we also conduct an annual impairment test of our goodwill and intangible assets with indefinite lives. The impairment test for goodwill includes two steps. Step one compares the fair value of the reporting unit with its carrying amount, including goodwill. If the carrying amount exceeds the fair value, then goodwill is impaired and step two is required to measure the amount of impairment loss. Step two compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount is greater than the implied fair value of the goodwill, an impairment loss is recognized for the excess. See Notes 1 and 6 to the Consolidated Financial Statements.

The impairment test for intangible assets with indefinite lives consists of a comparison of the fair value of the intangible asset with its carrying amount. Fair value is determined by calculating the present value of future estimated revenues. If the carrying amount of the intangible asset is greater than fair value, an impairment loss is recognized for the excess. See Notes 1 and 6 to the Consolidated Financial Statements.

Underground Gasoline Storage Tanks

Since 2002, we have recognized the estimated future cost to remove an underground storage tank over the estimated useful life of the storage tank in accordance with the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations." We record a discounted liability for the fair value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset at the time an underground storage tank is installed. We amortize the amount added to property and equipment and recognize accretion expense in connection with the discounted liability over the remaining life of the tank. We base our estimates of the anticipated future costs for removal of an underground storage tank on our prior experience with removal. We also consider factors such as the type of tank, location of tank sites and our experience with contractors who perform removal work. See Note 8 to the Consolidated Financial Statements.

Yen Loans

We use our license royalty receipts from Seven-Eleven Japan Co., Ltd. ("SEJ") to service the monthly principal and interest payments on our outstanding yen loans. This provides us with an economic hedge against fluctuations in the Japanese yen to U.S. dollar exchange rate. Since our adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," on January 1, 2001, we have adjusted the balance of the yen loans at each reporting date to reflect the then-current Japanese yen to U.S. dollar exchange rate, and we recognize the resulting noncash foreign currency exchange gain or loss in earnings. In addition, we record the SEJ royalty and interest expense on the yen loans at the average Japanese yen to U.S. dollar exchange rate for the respective periods. See "– Quantitative and Qualitative Disclosures About Market Risks – Foreign-Exchange Risk Management" and Notes 9 and 11 to the Consolidated Financial Statements.

Litigation and Tax Assessments

From time to time, we are subject to lawsuits and other claims. We assess the likelihood of any adverse judgments or outcomes to these matters as well as the potential range of probable losses. A determination of the amount of accrual required, if any, for these contingencies is made after careful analysis of each matter. The required accrual may change in the future due to new developments in any matter or changes in approach (such as a change in settlement strategy) in dealing with these issues. We believe that the final resolution of these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

Additionally, we are periodically engaged in various tax audits by federal and state governmental authorities incidental to our business activities. We record reserves for the estimated probable losses for certain of these proceedings. It is possible that additional losses associated with these audits may be incurred; however, we believe that the final resolution of these issues will not have a material adverse effect on our financial position, results of operations or cash flows.

Inventories

Inventories are stated at the lower of cost or market. Cost is generally determined by the last-in, first-out ("LIFO") method for company-operated stores in the United States and by the first-in, first-out ("FIFO") method for stores in Canada. Although the LIFO method generally matches the most recent product cost with related revenues, decreases in inventory quantities can result in a liquidation of LIFO inventory layers recorded at costs that are lower than the current costs, which would lower cost of goods sold and increase our margin. See Notes 1 and 3 to the Consolidated Financial Statements.

Workers' Compensation, General Liability and Medical Reserves

We have third-party insurance for workers' compensation and general liability losses with predetermined deductibles. We record our share of workers' compensation and general liability losses based on independent actuarial estimates of the aggregate liabilities for claims incurred. A significant change in claims experience or in the criteria which the actuary utilizes could result in a material revision to our liability.

Effective January 1, 2003, we changed our medical coverage from a fully insured plan to a self-insured plan. In lieu of paying fully insured premiums, which cover incurred claims plus administrative expenses, we pay claims and administrative expenses as they become due and establish reserves for incurred but unpaid claims as determined by an independent actuary.

Comparison of 2003 to 2002 Results

We have reclassified certain prior-year amounts to conform to the current-year presentation, such as the results of operations of certain owned and leased stores which are presented as discontinued operations in accordance with the provisions of SFAS No. 144 for all years discussed. Additionally, merchandise cost of goods sold of $155.5 million for the year ended December 31, 2002, has been recorded as a reduction to merchandise sales to reflect our revised accounting for sales of prepaid phone cards net of related costs. See Note 1 to the Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Net Sales

Years Ended December 31	2002	2003
Net Sales: *(in millions)*		
Merchandise sales	$7,020.5	$ 7,412.4
Gasoline sales	2,760.6	3,372.3
Total net sales	$9,781.1	$10,784.7
U.S. same store merchandise sales growth	3.1%	3.2%
Gasoline gallons sold *(in millions)*	1,987.3	2,117.0
Gasoline gallon sales change per store	4.5%	4.2%
Average retail price of gasoline per gallon	$ 1.39	$ 1.59

Merchandise sales for 2003 increased $391.9 million, or 5.6%, over 2002. U.S. same-store merchandise sales increased 3.2% for 2003, on top of a 3.1% increase for 2002. Continued improvement in same-store sales reflects the ongoing implementation of our strategic initiatives and consistent introduction of new products. Key contributors to the merchandise sales growth in 2003 were increases in fresh food, beverages, beer and cigarettes.

Gasoline sales for 2003 increased $611.7 million, or 22.2%, over 2002. We attribute the increased sales to a 20-cent increase in the average retail price of gasoline and to a 4.2% increase in per-store gallons sold in 2003. The increases in gasoline gallons sold and per-store gallons sold are primarily due to our day-to-day management of gasoline markets and retail pricing.

Gross Profit

Years Ended December 31	2002	2003
Gross Profit: *(in millions)*		
Merchandise gross profit	$2,496.1	$2,634.6
Gasoline gross profit	254.2	326.3
Total gross profit	$2,750.3	$2,960.9
Merchandise gross profit margin	35.55%	35.54%
Merchandise gross profit growth per store	4.9%	3.7%
Gasoline gross profit margin cents per gallon	12.79	15.41
Gasoline gross profit change per store	(4.5)%	25.6%

Merchandise gross profit for 2003 was $2,634.6 million, an increase of $138.5 million, or 5.5%, over 2002. Products contributing to our merchandise gross profit dollar growth include fresh food items, noncarbonated beverages, cigarettes, hot beverages, beer, tobacco and soft drinks. Gross profit margin in 2003 was 35.54% compared to 35.55% in 2002. The 5.5% year-over-year increase in gross profit dollars compared to a relatively small change in gross profit margin is attributable to our strategy of maximizing gross profit dollars. Our changing product mix affects merchandise margins as we sell more items that contribute to gross profit dollars but negatively impact gross profit margin, such as cigarette cartons. The impact of product assortment changes was partially offset by the continued emphasis on managing cost of goods sold.

Gasoline gross profit for 2003 was $326.3 million, compared to $254.2 million in 2002. Expressed as cents per gallon, our gasoline margin was 15.41 cents for 2003 compared to 12.79 cents for 2002. This translated into a 25.6% increase in our average gasoline gross profit per store for 2003. Daily management of gasoline combined with a more favorable market place allowed for increased gasoline margins.

We manage retail gasoline prices through a centralized monitoring process to minimize the effect of gasoline margin volatility and maximize our gross profit per gallon. Increases or decreases in the wholesale cost of gasoline will generally cause similar increases or decreases in the retail price of gasoline. An increase in the wholesale cost of gasoline generally results in higher retail prices within five to 10 days after the cost increase. Conversely, a decrease in the wholesale cost of gasoline generally results in lower retail prices within 15 to 20 days after the cost decrease. Competitive conditions in the retail marketplace can cause these time periods to vary considerably on a market-by-market basis, which can have a significant impact on gasoline gross profit margin. Over the last 10 years, however, our annual gasoline gross profit margins on a cent-per-gallon basis have remained comparatively stable at or above the 13-cent-per-gallon level.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Other Income

Other income consists primarily of area license royalties, Vcom fees and initial franchise fees. Other income for 2003 was $97.0 million, a decrease of $5.9 million, or 5.8%, from $102.9 million in 2002. Royalty income from our area licensees was $52.0 million in 2003, a decrease of $19.6 million from $71.6 million in 2002. This decrease was primarily due to the previously anticipated reduction in the SEJ licensing royalty rate. Under the terms of a 1988 amendment to our licensing agreement with SEJ, the royalty payments to us were reduced by approximately 70% beginning in August 2002. The decrease in the licensing royalties was partially offset by an increase of $17.2 million in Vcom fee income. See "– Liquidity and Capital Resources – Vcom."

Franchisee Gross Profit Expense

Franchisee gross profit expense for 2003 was $798.0 million, an increase of $55.2 million, or 7.4%, from $742.8 million in 2002, due to higher per-store gross profits at franchised stores and an increase in the number of stores operated by franchisees. See "– Critical Accounting Policies and Estimates – Franchisees" and Note 1 to the Consolidated Financial Statements.

Operating, Selling, General and Administrative Expense ("OSG&A")

The primary components of OSG&A are store labor, occupancy (including depreciation) and corporate expenses. OSG&A for 2003 was $2,047.5 million, an increase of $104.3 million, or 5.4%, from $1,943.2 million in 2002. We attribute this increase primarily to costs associated with higher occupancy expenses, higher employee-related costs and increased credit card processing fees. We expect OSG&A to grow at a rate less than that of overall gross profit.

The ratio of OSG&A to revenues decreased to 18.8% for 2003 from 19.7% in 2002. Included in 2003 OSG&A was a $10.5 million gain due to the redemption of the senior subordinated debentures, an $11.0 million currency conversion loss and a $1.7 million charge related to infrastructure consolidation and other expenses. The 2003 charge for infrastructure consolidation and other expenses includes a $7.0 million charge related to the California remediation receivable balance and a $3.9 million gain related to life insurance proceeds. Included in 2002 OSG&A was a $14.9 million currency conversion loss and $10.7 million related to infrastructure consolidation and other expenses.

In September 2003, we announced our plans to explore opportunities to restructure our ownership position in Cityplace, the office tower that serves as our corporate headquarters. We are continuing to pursue those plans.

Interest Expense, Net

Net interest expense for 2003 was $71.3 million, an increase of $6.6 million, or 10.2%, from $64.7 million in 2002. The increase is primarily due to new borrowings of senior subordinated debt and to a lesser extent the impact of consolidated debt in accordance with FIN 46. These increases were partially offset by lower average borrowings under our commercial paper facility at lower average interest rates in 2003 than in 2002. See "– Liquidity and Capital Resources," " – Quantitative and Qualitative Disclosures About Market Risks – Interest Rate Risk Management," and Note 9 to the Consolidated Financial Statements.

In accordance with SFAS No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructuring," ("SFAS No. 15 Interest") our debentures were recorded at an amount equal to the undiscounted cash payments of both principal and interest, and we did not recognize interest expense on our debentures in our condensed consolidated statement of earnings. Accordingly, until the debentures were retired in July 2003, we charged the cash interest payments against the recorded amount of the debentures.

Income Tax Expense

Income tax expense for 2003 was $53.6 million, an increase of $12.6 million, or 30.8%, from $41.0 million in 2002. Our effective tax rate was 38.0% for 2003, compared to 40.0% in 2002.

Discontinued Operations

Discontinued operations for 2003 resulted in a loss of $13.1 million (net of $8.0 million income tax benefit) compared to a loss of $20.5 million (net of $13.7 million income tax benefit) for the same period in 2002. These stores had total revenues of $93.4 million and $210.9 million and pretax operating losses of $21.1 million and $34.2 million for 2003 and 2002, respectively. Included in the loss on discontinued operations are losses on disposal of $6.2 million (net of $3.8 million tax benefit) and $13.9 million (net of $9.2 million tax benefit) for the years ended December 31, 2003 and 2002, respectively. The pretax loss for 2003 includes a gain of $5.3 million from the sale of 12 nonstrategic stores in Wisconsin. The losses on disposal include write-downs of stores to net realizable value, anticipated future rent and other expenses in excess of related estimated sublease income, as well as gains and losses on sales of stores.

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Cumulative Effect of Accounting Change

Effective July 1, 2003, we adopted FIN 46, which resulted in a one-time charge of $10.2 million, net of deferred tax benefit, related to the cumulative effect of the accounting change resulting from the consolidation of two trusts that provided us with off balance sheet financing. See "– Other Issues – Recently Issued Accounting Standards" and Note 12 to the Consolidated Financial Statements.

On January 1, 2002, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations," which resulted in a one-time charge of $28.1 million, net of deferred tax benefit, related to the cumulative effect of the accounting change which relates to the accounting for costs associated with future removal of underground gasoline storage tanks. See Note 8 to the Consolidated Financial Statements.

Net Earnings

Net earnings for 2003 were $64.1 million, or $0.58 per diluted share, an increase of $51.3 million from $12.8 million, or $0.13 per diluted share in 2002.

Comparison of 2002 to 2001 Results

We have reclassified certain prior-year amounts to conform to the current-year presentation, such as the results of operations of certain owned and leased stores which are presented as discontinued operations in accordance with the provisions of SFAS No. 144 for all years discussed. Additionally, merchandise cost of goods sold amounts of $136.4 million and $155.5 million for the years ended December 31, 2001 and 2002, respectively, have been recorded as a reduction to merchandise sales to reflect our revised accounting for sales of prepaid phone cards net of related costs. See Note 1 to the Consolidated Financial Statements.

Net Sales

Years Ended December 31	2001	2002
Net Sales: *(in millions)*		
Merchandise sales	$6,672.1	$7,020.5
Gasoline sales	2,636.6	2,760.6
Total net sales	$9,308.7	$ 9,781.1
U.S. same store merchandise sales growth	2.8%	3.1%
Gasoline gallons sold *(in millions)*	1,813.6	1,987.3
Gasoline gallon sales change per store	4.3%	4.5%
Average retail price of gasoline per gallon	$ 1.45	$ 1.39

Merchandise sales for 2002 increased $348.4 million, or 5.2%, over 2001. U.S. same-store merchandise sales increased 3.1% for 2002, on top of 2.8% for 2001. Continued improvement in same-store sales is a result of our focus on product assortment, introducing new items and improving the quality of existing items. Key contributors to the merchandise sales growth in 2002 were increases in cigarettes, beer, noncarbonated beverages, fresh food items and candy. Partially offsetting these increases was a decrease in our sales of Café Cooler frozen beverages.

Gasoline sales for 2002 increased $124.0 million, or 4.7%, over 2001. We attribute this increase to a 4.5% increase in per-store gallons sold, partially offset by a 6-cent decline in the average retail price of gasoline in 2002. The increase in per-store gallons sold is primarily due to the addition of new higher-volume gasoline stores, which typically have more gasoline pumps than existing stores.

Gross Profit

Years Ended December 31	2001	2002
Gross Profit: *(in millions)*		
Merchandise gross profit	$2,333.8	$2,496.1
Gasoline gross profit	253.7	254.2
Total gross profit	$2,587.5	$2,750.3
Merchandise gross profit margin	34.98%	35.55%
Merchandise gross profit growth per store	3.6%	4.9%
Gasoline gross profit margin cents per gallon	13.99	12.79
Gasoline gross profit change per store	7.3%	(4.5)%

Merchandise gross profit for 2002 was $2,496.1 million, an increase of $162.3 million, or 7.0%, over 2001. Gross profit margin in 2002 increased 57 basis points to 35.55% from 34.98% in 2001. Our overall gross profit margin increase and gross profit growth per

in write-offs and shortages. Some of our faster growing products were beer, noncarbonated beverages, fresh food items and candy. During the third quarter of 2002, we signed a new primary wholesale agreement with McLane Company, which supported our cost containment efforts and has increased service levels to our stores.

Gasoline gross profit for 2002 was $254.2 million, basically flat with 2001. Our gasoline gross profit per gallon decreased to 12.79 cents for 2002 compared to 13.99 cents for 2001. This translated into a 4.5% decrease in our average gasoline gross profit per store for 2002. These declines were primarily due to difficult market conditions in the first quarter of 2002 when retail prices fell faster than wholesale costs, causing lower retail margins.

Other Income

Other income consists primarily of area license royalties and initial franchise fees. Other income for 2002 was $102.9 million, a decrease of $9.0 million, or 8.0%, from $111.9 million in 2001. Royalty income from our area licensees was $71.6 million in 2002, a decrease of $13.2 million from $84.8 million in 2001. The decrease was primarily due to a $17.7 million decrease in the royalties received from our licensing agreement with SEJ under which SEJ pays us a royalty fee based on a percentage of its total revenues. Under the terms of a 1988 amendment to that agreement, SEJ reduced its royalty payments to us by approximately 70% beginning in August 2002. In addition, we experienced an unfavorable impact from changes in the Japanese yen to U.S. dollar exchange rate during 2002. The royalty rate reduction and the impact of the exchange rate changes were partially offset by increases in franchise fees, other area license royalties and Vcom fees.

Franchisee Gross Profit Expense

Franchisee gross profit expense for 2002 was $742.8 million, an increase of $44.7 million, or 6.4%, from $698.1 million in 2001, due to higher per-store gross profits at franchised stores and an increase in the number of stores operated by franchisees. See "– Critical Accounting Policies and Estimates – Franchisees" and Note 1 to the Consolidated Financial Statements.

Operating, Selling, General and Administrative Expense

The primary components of OSG&A are store labor, occupancy (including depreciation) and corporate expenses. OSG&A for 2002 was $1,943.2 million, an increase of $171.8 million, or 9.7%, from $1,771.4 million in 2001. We attribute this increase primarily to costs associated with higher occupancy expenses from store openings, higher employee-related costs and increased technology-related expenses.

The ratio of OSG&A to revenues increased to 19.7% for 2002 from 18.8% in 2001. Included in 2002 OSG&A was a $14.9 million currency conversion loss and $10.7 million related to infrastructure consolidation and other expenses. OSG&A for 2001 includes $19.8 million of goodwill and other intangible assets amortization expense, which was eliminated in 2002 upon the adoption of SFAS No. 142. See Note 6 to the Consolidated Financial Statements.

Interest Expense, Net

Net interest expense for 2002 was $64.7 million, an increase of $2.0 million, or 3.2%, from $62.7 million in 2001. The increase is primarily due to a decrease in interest income as a result of lower interest rates.

Income Tax Expense

Income tax expense for 2002 was $41.0 million, a decrease of $24.2 million, or 37.2%, from $65.2 million in 2001. Our effective tax rate was 40.0% for 2002, compared to 39.0% in 2001.

Discontinued Operations

Discontinued operations for 2002 resulted in a loss of $20.5 million (net of $13.7 million income tax benefit) compared to a loss of $8.4 million (net of $5.4 million income tax benefit) for the same period in 2001. These stores had total revenues of $210.9 million and $337.1 million and pretax operating losses of $34.2 million and $13.8 million for 2002 and 2001, respectively. Included in the loss on discontinued operations are losses on disposal of $13.9 million (net of $9.2 million tax benefit) and $3.2 million (net of $2.1 million tax benefit) for the years ended December 31, 2002 and 2001, respectively.

Cumulative Effect of Accounting Change

On January 1, 2002, we adopted SFAS No. 143, which resulted in a one-time charge of $28.1 million, net of deferred tax benefit, related to the cumulative effect of the accounting change which relates to the accounting for costs associated with future removal of underground gasoline storage tanks. See Note 8 to the Consolidated Financial Statements.

On January 1, 2001, we adopted SFAS No. 133, which resulted in a one-time charge of $9.8 million, net of taxes, related to the cumulative effect of the accounting change on our yen-denominated debt. See Note 11 to the Consolidated Financial Statements.

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Net Earnings

Net earnings for 2002 were $12.8 million, or $0.13 per diluted share, a decrease of $70.9 million, or 84.7%, from $83.7 million, or $0.75 per diluted share in 2001.

Liquidity and Capital Resources

We obtain the majority of our working capital from these sources:

- Cash flows generated from our operating activities;
- A $650 million commercial paper facility, guaranteed by Ito-Yokado Co., Ltd. ("IY");
- Borrowings of up to $200 million under our revolving credit facility.

We believe that operating activities and available working capital sources will provide sufficient liquidity in 2004 to fund our operating costs, capital expenditures and debt service. In addition, we intend to continue accessing the leasing market to finance our new stores and certain equipment.

We expect capital expenditures for 2004, excluding lease commitments, will be between $345 million and $375 million. Capital expenditures for 2004 are expected to include the key areas of new stores, information technology and maintenance. For 2003, our capital expenditures were primarily related to developing new stores, maintenance activities and information technology. We opened 95 stores in 2003 and expect to open approximately 100 stores during 2004.

In January 2003, we entered into a note purchase agreement with SEJ that authorized the issuance and sale of up to $400 million aggregate principal amount of Senior Subordinated Notes due 2010 ("SEJ Notes"), which we issued and SEJ purchased in multiple tranches. The SEJ Notes are subordinate to all obligations outstanding under our revolving credit facility. On January 10, 2003, we received $100 million from SEJ under the note purchase agreement; the interest rate on this tranche is 3.41%. On July 9, 2003, we received the remaining $300 million from SEJ under the note purchase agreement in three equal payments of $100 million; the interest rate on these tranches is 3.01%, 3.34%, and 3.71% respectively. We are required to repay the SEJ notes in eight semiannual installments beginning July 2006 and ending January 2010.

In July 2003, we used a portion of the proceeds of the SEJ Notes to retire $239.3 million principal amount of our 5% First Priority Senior Subordinated Debentures due 2003, $111.4 million principal amount of our 4½% Second Priority Senior Subordinated Debentures (Series A) due 2004 and $18.5 million principal amount of our 4% Second Priority Senior Subordinate Debentures (Series B) due 2004. Primarily as a result of including the SFAS No. 15 Interest in the carrying amount of the retired debt, we recognized a pretax gain of $10.5 million in connection with the retirement, which was recorded in OSG&A.

During the period the Senior Subordinated Debentures were outstanding, we did not recognize interest expense on this debt. Because we recognize interest on the SEJ Notes, interest expense increased $8.1 million for 2003 and we expect an increase of approximately $14 million annually beginning in 2004. See "– Comparison of 2003 to 2002 Results – Interest Expense, Net."

In September 2003, all of the outstanding 1998 Convertible Quarterly Income Debt Securities due 2013 ("1998 QUIDS"), which were issued to IY and SEJ were converted into approximately 6.5 million shares of 7-Eleven common stock. The principal amount of the 1998 QUIDS was $80.0 million, and the interest rate was 4.5%. As a result of the conversion, which was mandatory under the terms of the 1998 QUIDS, our 2003 interest expense decreased by $1.1 million and our 2004 interest expense will decrease by $2.5 million.

While we are rated investment grade by two ratings agencies, Standard & Poor's and Moody's, we also receive direct and indirect support from our majority shareholder. Over time, it is our intention to improve our credit ratio statistics to more accurately reflect the ratio requirements of an investment grade rating on a stand-alone basis.

Vcom®

Vcom is our proprietary self-service kiosk solution to meet consumer demands for convenient and continuously available financial and e-commerce services. We believe that the deployment of these Web-enabled, integrated services kiosks represents a significant market opportunity to offer financial and e-commerce services to a large segment of our current and future customers who have little or no access to banks or the Internet. We believe we are uniquely positioned to capitalize on this opportunity because of the demographics of our existing customer base and the large number of our conveniently located stores. Through exclusive agreements with third-party service providers, we currently offer or plan to offer traditional ATM services, money orders and money transfer services, check-cashing, prepaid phone cards, auto insurance, stored value cards and bill payment services.

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We announced plans in the third quarter of 2002 to expand our rollout of Vcom to 1,000 stores, adding to our original Vcom pilot program in Texas and Florida. As of December 31, 2003, this expanded rollout was complete. We funded the $55 million capital investment needed for the Vcom rollout primarily through a capital lease program. As of December 31, 2003, we had $96.3 million of cash in the Vcom kiosks to fund check-cashing and ATM transaction and money transfer disbursements to customers. We are currently funding this requirement through our commercial paper program. During the first quarter of 2004, we expect to enter into an arrangement with a commercial bank that will provide the cash in the Vcom kiosks. The fee to be charged to us by the commercial bank for our use of its cash will be reflected in our OSG&A expense.

In exchange for our granting strategic partners exclusive rights to offer their services or products on our Vcom kiosks, the partners are required to pay placement fees, a percentage of the transaction fees and, in certain circumstances, expense reimbursement. Fee commitments for the 1,000 units total approximately $140 million. As of December 31, 2003, we have received $65.9 million in payments from our Vcom partners, $30.5 million of which has not been recognized in earnings and has been included in our Consolidated Balance Sheet as deferred income. With the exception of fees associated with funding the pilot program, which were amortized over the term of the program, we will amortize substantially all fee income over the term of the applicable agreement.

Contractual Obligations and Commercial Commitments

Financial Obligations. A summary of our material contractual cash obligations under our long-term debt, leases and convertible quarterly income debt securities ("QUIDS") as of December 31, 2003, is as follows (in millions):

	2004	2005	2006	2007	2008	Thereafter	Total
Long-Term Debt[1]	$ 23.5	$306.0	$159.4	$115.9	$117.3	$ 528.7	$1,250.8
Capital Lease Obligations	36.5	38.7	36.6	32.9	26.3	194.8	365.8
Operating Lease Obligations	194.8	167.1	145.0	119.4	95.0	658.7	1,380.0
QUIDS	—	—	—	—	—	300.0	300.0
Total	$254.8	$511.8	$341.0	$268.2	$238.6	$1,682.2	$3,296.6

(1) Includes $318.6 million of commercial paper, all of which is classified in "thereafter."

Long-Term Debt. We have $650 million available under our commercial paper facility, of which $318.6 million was outstanding as of December 31, 2003. We have classified the entire outstanding amount as noncurrent debt because we intend to maintain at least this amount outstanding during the next year. Such debt is unsecured and is fully and unconditionally guaranteed by IY through 2005 under a written agreement. If we fail to repay the commercial paper as it matures, IY will become obligated to make such payments under its guarantee of our commercial paper facility. We would, in turn, be obligated to reimburse IY, subject to some restrictions in our credit agreement, for the costs associated with such a payment. Our credit agreement restrictions principally specify that we cannot make reimbursements until one year after we repay, in full, all amounts outstanding under the credit agreement. See "– Other Issues – Related Party Transactions – Commercial Paper" and Note 9 to the Consolidated Financial Statements.

Our other long-term debt primarily consists of SEJ Notes of $400.0 million, a term loan of $207.9 million, yen-denominated loans of $144.4 million and $178.1 million in notes payable to senior lenders. See Note 9 to the Consolidated Financial Statements.

Capital and Operating Lease Obligations. We utilize leases as a means of funding our property and equipment. Generally, real estate leases are for primary terms from 10 to 20 years with options to renew for additional periods and equipment leases are for terms from three to 10 years. Ground leases for stores are recorded as operating leases, while leased buildings and equipment are recorded as capital or operating leases in accordance with generally accepted accounting principles. Capital lease obligations and related assets are included in our Consolidated Balance Sheet. Operating lease obligations and related assets are not included in our Consolidated Balance Sheet.

Store Leases. As of December 31, 2003, we operated or franchised a total of 5,784 stores in the United States and Canada. We own less than one-third of these stores, and we lease the remainder. Over the next five years, leases covering more than half of our total leased stores will expire, including more than 1,300 leases that lack rent renewal options or contain negotiable rent options and more than 1,100 leases that have fixed rent options. We have devoted, and will continue to devote, considerable efforts to extending and/or renegotiating these leases.

	2004	2005	2006	2007	2008	Total
Lease Expiring or with Negotiable Rent Options	174	244	311	306	289	1,324
Fixed Rent Options	46	205	282	316	278	1,127
Total	220	449	593	622	567	2,451

We originally signed many of the expiring leases or leases with negotiable options in the 1970s and 1980s. Some of these leases had primary terms of 10 to 20 years, with as many as three options to renew for additional five-year terms. For those sites where we need to negotiate (a) a new lease to replace an expiring lease or (b) a new rental for those leases that have negotiable rent renewal options, we expect that we will pay prevailing market rates when the new lease term or option term commences, which will likely significantly increase our operating costs. If we are unable to agree on an appropriate rent for any one of these stores, we may decide to forego renewal of the lease and close the store.

If we have a fixed rent option, in most cases the rent will increase either to a specific predetermined dollar amount or as calculated based on a predetermined formula, such as an increase in the consumer price index. These rent increases will increase our operating costs.

QUIDS. IY and SEJ currently hold $300 million of QUIDS from a transaction consummated in 1995. These securities can be converted into our common stock at predetermined prices. The securities bear interest at 4.5% annually and are subordinate to all existing debt. See "– Other Issues – Related Party Transactions – QUIDS" and Note 10 to the Consolidated Financial Statements.

Revolving Credit Facility. There was no funded debt outstanding under the revolver at December 31, 2003. Letters of credit outstanding under the facility totaled $113.8 million at December 31, 2003, and reduced available funds under the revolving credit facility to $86.2 million. Interest on borrowings are based on a variable rate equal to the administrative agent bank's base rate or, at our option, a rate equal to a reserve-adjusted Eurodollar rate plus a margin determined by our credit rating for senior long-term indebtedness.

Our revolving credit facility contains various financial and operating covenants that require us, among other things, to maintain certain financial ratios, including interest and rent coverage, consolidated total indebtedness and consolidated senior indebtedness to earnings before interest, income taxes, depreciation, amortization and the interest component of rent expense on certain lease facilities. The facility also contains covenants which, among other things, limit (a) our ability to incur or guarantee indebtedness or other liabilities other than under the facility, (b) our ability to engage in asset sales and sale/leaseback transactions, (c) the types of investments we can make and (d) our ability to pay cash dividends or redeem or prepay principal and interest on any subordinated debt. The bank's funding obligations are contingent on our financial operations. If we suffer a material adverse change, the bank would not have to fund the facility. We do not anticipate drawing down any funds under our revolver in the near future. See Note 9 to the Consolidated Financial Statements.

Purchase Commitments. We have various material contracts with service and product vendors that contain commitments to purchase minimum levels of products or services. We also have material commitments for capital projects. We have estimated our material minimum purchase commitments as of December 31, 2003. These estimated commitments are summarized as follows (in millions):

	2004	2005	2006	2007	2008	Thereafter	Total
Distribution Services(1)	$ 910.0	$ 940.0	$ —	$ —	$ —	$ —	$1,850.0
Gasoline Supply(1)	904.0	931.0	719.0	—	—	—	2,554.0
IT Commitments	56.0	31.0	25.0	25.0	25.0	—	162.0
Product and Other Commitments(2)	63.0	63.0	51.0	46.0	11.0	11.0	245.0
Capital Commitments	165.0	—	—	—	—	—	165.0
Total	$2,098.0	$1,965.0	$795.0	$71.0	$36.0	$11.0	$4,976.0

(1) We have estimated our future purchase commitments based on volumes purchased and our average cost for 2003 increased annually by approximately 3%.
(2) We have estimated our future purchase commitments based on our contracted volume at 2003 prices.

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Distribution Services. We have a service agreement through January 2006 with McLane Company, Inc., under which McLane is the primary distributor of traditional grocery products to our U.S. stores and designated combined distribution centers in the United States. Under the terms of the agreement, we are required to purchase a minimum percentage of eligible purchases from McLane. We exceeded the minimum percentage in 2002 and 2003 and we expect to meet the minimum percentage in 2004. Our failure to purchase the minimum percentage of eligible purchases could result in a change in pricing of certain products.

Gasoline Supply. We are currently in the 18th year of a 20-year product purchase agreement with Citgo Petroleum Corporation. This agreement, which expires in September 2006, permits us to purchase gasoline from parties other than Citgo, but obligates us to purchase specified quantities of gasoline at market prices from Citgo. The minimum required annual purchases under this agreement are generally the lesser of 750 million gallons or 35% of all of the gasoline we purchase for retail sale. We have exceeded the minimum required annual purchases in all material respects in each year of the contract and expect to continue doing so in the future. See Note 14 to the Consolidated Financial Statements.

IT Commitments. We have various information technology commitments that require us to purchase minimum amounts of products and services annually. We have exceeded such minimum purchase requirements in the past in all material respects and expect to continue doing so for the foreseeable future. Our failure to satisfy the minimum purchase requirements could cause us to make payments to the applicable provider(s) equal to the commitment(s) or a predetermined percentage of the commitment(s).

Product Commitments. We have various product purchase contracts that require us to purchase a minimum amount of products annually. We have generally exceeded such minimum purchase requirements in the past and expect to continue doing so for the foreseeable future. Our failure to satisfy the minimum purchase requirements could result in termination of the contracts, changes in pricing of the products and payments to the applicable provider(s) of a predetermined percentage of the commitment(s), which would not exceed $7 million annually.

Other. We have guaranteed $3.7 million of a five-year, $15 million note between one of our equity affiliates and a third-party lending institution. The affiliate obtained the loan to restructure existing debt. The guaranteed amount is the maximum potential amount that we could be required to pay in the event of default by the affiliate.

We have contracts with certain of our combined distribution center operators that require us to process a certain level of products through the facilities. If we fail to do so, we must pay the applicable operator a predetermined fee. We estimate that we will pay approximately $8.0 million in such fees over the next three years. For the years ended December 31, 2001, 2002 and 2003, we paid $554,000, $897,000 and $3.8 million, respectively. These amounts are reflected in merchandise cost of goods sold.

Our franchise agreement includes a guarantee to our franchisees of a minimum amount of annual gross income, which is the franchisee's share of the gross profit split. By policy, and not as part of the franchise agreement, we also offer an additional gross income guarantee to our franchisees if certain conditions are met. Under these programs, we reduce our share of the gross profit split such that the franchisee will receive the guaranteed amount, generally $60,000 per year. We reduced our share of the gross profit split from franchisees under the combined programs by $1.0 million, $932,000 and $762,000 for the years ended December 31, 2001, 2002 and 2003, respectively. See Note 1 to the Consolidated Financial Statements.

Cash Flows from Operating Activities

Net cash provided by operating activities for 2003 was $534.5 million compared to $496.7 million for 2002. We attribute this increase primarily to increased earnings during 2003. Additionally, there were changes in working capital items which are primarily attributed to the timing of receipt of vendor allowances and other receivables, the timing of the funding for money orders, the timing of the payment of merchandise and gasoline payables, and decreases in employee benefit payables.

Cash Flows from Investing Activities

Net cash used in investing activities for 2003 was $335.7 million, a decrease of $108.6 million, or 24.5%, from $444.3 million for 2002. The primary driver of the decrease was an $88.0 million decrease in capital expenditures to $338.3 million for 2003. Capital expenditures decreased as a result of expenditure reduction efforts in 2003 and the completion in 2002 of a scheduled equipment upgrade. Also contributing to the decrease was the change in restricted cash of $16.1 million in 2003 compared to $37.1 million in 2002, which was a result of the decrease in the royalties received from our licensing agreement with SEJ. Restricted cash represents funds escrowed for the semiannual payment on our yen-denominated loans.

Cash Flows from Financing Activities

Net cash used in financing activities was $135.2 million for 2003, an increase of $77.9 million from $57.3 million for 2002. Contributing to this increase were $400 million in proceeds from the borrowings under the SEJ Notes, repayments of long-term debt of $400.2 million which consisted primarily of $369.2 million related to the redemption of the senior subordinated debentures, and net payments under commercial paper facilities for 2003 of $157.3 million.

Other Issues

Related Party Transactions

As of December 31, 2003, IYG Holding Co. ("IYG"), SEJ and IY, collectively held 73.88% of our common stock. IYG is owned 51% by IY and 49% by SEJ, which is a majority-owned subsidiary of IY. IYG is a Delaware corporation that was formed in 1991 to acquire and hold our common stock.

Commercial Paper. We entered into an agreement with IY pursuant to which IY agreed to fully and unconditionally guarantee our commercial paper facility. As a result of this guarantee, we achieve lower interest rates and better credit ratings than would otherwise be possible. Both the interest rates we pay on our commercial paper and our credit rating are affected by IY's credit rating, and a significant downgrade of IY's credit rating could adversely affect us. Due to IY's significant indirect ownership interest in our company, we expect our relationship with IY to continue in the future. See "– Liquidity and Capital Resources – Contractual Obligation and Commercial Commitments – Financial Obligations – Long-Term Debt" and Notes 1 and 9 to the Consolidated Financial Statements.

QUIDS. IY and SEJ hold $300 million of QUIDS from a transaction consummated in 1995. These securities can be converted into our common stock at predetermined prices. The securities bear interest at 4.5% annually and are subordinate to all existing debt. The terms and conditions of the QUIDS transaction were approved in advance by a Special Committee comprised of three independent members of our board of directors. In deciding whether to approve the transaction, the Special Committee relied, in part, on fairness opinions delivered to the committee by financial institutions who conducted extensive due diligence prior to issuing their opinions. See Note 10 to the Consolidated Financial Statements.

License Royalties. In 2003 we received over $20 million of royalties from our area license agreement with SEJ. See Notes 1 and 9 to the Consolidated Financial Statements.

SEJ Notes. SEJ holds $400 million of Senior Subordinated Notes that we issued in 2003. These notes were issued in four tranches under a 2003 note purchase agreement with SEJ. The weighted average interest rate for the SEJ notes is 3.37%.

Expansion into China. There are currently 484 7-Eleven stores in Hong Kong and approximately 150 7-Eleven stores in the south China province of Guangdong operated by subsidiaries of Dairy Farm International Ltd. pursuant to a licensing arrangement.

We have been pursuing the possibility of entering into a licensing arrangement for the greater Beijing market area with a joint venture that was originally formed by SEJ, President Chain Store Corporation and two Chinese participants. President Chain Store Corporation is our current licensee in Taiwan, where it operates approximately 3,500 stores, and Seven-Eleven Japan is our current licensee in Japan, where it operates approximately 10,000 7-Eleven stores. We have focused on the possibility of negotiating a licensing arrangement with SEJ and President Chain Store Corporation because of their financial strength, business experience in China and proven ability to develop and operate 7-Eleven stores.

Because SEJ, together with IY and IYG Holding, owns approximately 74% of our common stock, our Board of Directors appointed a Special Committee of three directors, none of whom is affiliated with SEJ, IY or any of the proposed joint venture partners, to review and consider the proposed licensing arrangement for approval.

During the third quarter of 2003, the Special Committee approved the essential financial terms for the licensing arrangement with the joint venture. In addition, the Committee authorized us to proceed to negotiate the other terms and conditions of an area license agreement, which the Committee will then review and consider for final approval.

During the first quarter of 2004, the Ministry of Commerce in the People's Republic of China approved the formation of a joint venture among SEJ, Beijing ShouLian Commercial Group Co., Ltd., and China National Sugar & Alcohol Group Corporation. Our licensee in Taiwan, President Chain Store Corporation, has entered into an agreement with the other joint venture participants, providing for its purchase of a minority interest in the joint venture, subject to the satisfaction of certain People's Republic of China governmental requirements. Once an area license agreement has been executed with us, the joint venture will start to develop 7-Eleven stores in Beijing and surrounding area. The first stores are expected to open in the spring of 2004.

Environmental

At December 31, 2003, our estimated undiscounted liability for our environmental costs related to remedial action at existing and previously operated gasoline storage sites and other operating and nonoperating properties where releases of regulated substances have been detected was $38.5 million. We anticipate that substantially all of the future remediation costs for detected releases of regulated substances at remediation sites of which we are aware, as of December 31, 2003, will primarily be incurred within the next five to six years. The estimated liability could change within the near future for several reasons, including (a) revisions to or the creation of governmental requirements, (b) existing remediation projects become fully defined, resulting in revised estimates of the cost to finish the projects and (c) unplanned future failures of underground gasoline storage tank systems.

Under state reimbursement programs, we are eligible to be reimbursed for a portion of future remediation costs, as well as a portion of remediation costs previously incurred. At December 31, 2003, we had recorded a net receivable of $51.7 million for the estimated state reimbursements, of which $28.0 million relates to remediation costs incurred in the State of California. In assessing the probability of state reimbursements, we take into consideration each state's fund balance, revenue sources, existing claim backlog, status of cleaning activity and claim ranking. As a result of these assessments, the recorded receivable amounts at December 31, 2003, are net of allowances of $11.4 million. The estimated future state reimbursement amounts could change within the near future as governmental requirements and state reimbursement programs continue to be revised or extended.

While we cannot be certain of the timing of our receipt of state reimbursement funds, based on our experience we expect to receive the majority of state reimbursement funds within one to three years after our payment of eligible remediation expenses. This time period assumes that the state administrative procedures for processing such reimbursements have not changed.

The exception to our assumption regarding the timing of when we will receive state reimbursement funds is in California. The California reimbursement program separates claims into four classes: A, B, C and D. Our claims are in class D. As a result of the growing backlog of class D claims and its impact on our estimate of when we will receive funds from the California reimbursement program, we recorded a pretax charge to OSG&A of $7.0 million in the third quarter of 2003 to reflect our best estimate of the fair value of our California remediation receivable. We have recorded the portion of the receivable that relates to remediation activities that have already been completed at a discount rate of approximately 5.0%. Thus, in addition to the allowance discussed above, the recorded receivable amount is also net of a discount of $19.2 million.

Any revisions to our estimated future remediation expenditures and related state reimbursement amounts could have a material impact on our operations and financial position.

Franchise Agreement Renewal

We have approximately 3,300 franchised stores. Of that number, approximately 34% are subject to franchise agreements that were scheduled to expire on December 31, 2003. We have developed a new franchise agreement to replace the expiring agreements and to offer to our other franchisees. The new agreement includes revisions to the gross profit split between us and the franchisees and provides for an advertising fee to be paid by the franchisees to us for certain advertising costs that we may incur. Additionally, the new agreement includes a provision requiring that a minimum percentage of the franchisees' total purchases must be from our recommended vendors. The agreement is designed to better align our franchisees with our business strategies involving fresh foods, combined distribution and differentiation and to increase profits for our franchisees and us.

A committee of our franchisees has evaluated the economic impact of the new agreement on our franchisees according to a procedure set forth in a 1998 court-approved settlement agreement. On February 23, 2004, the committee advised us that the new agreement satisfies the economic impact standard contained in the settlement agreement. Therefore, existing franchisees – regardless of whether their agreement has expired – and new franchisees are being offered the chance to sign the new agreement during 2004.

We do not anticipate that the terms of the new agreement will have a material adverse impact on our franchisees or us.

Recently Issued Accounting Standards

In April 2003, the FASB issued SFAS No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, for hedging relationships designated after June 30, 2003, and to certain preexisting contracts. We have adopted the provisions of SFAS No. 149; adopting the statement did not have a material impact on our consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody

obligations of the issuer and have characteristics of both liabilities and equity. The provisions of SFAS No. 150 are effective for all financial instruments created or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. We adopted the provisions of SFAS No. 150 as of July 1, 2003; adopting the statement did not have a material impact on our consolidated financial statements.

The FASB issued a revision to SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," in December 2003. The statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, "Employers' Accounting for Pensions," SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The revised SFAS No. 132 retains the disclosure requirements contained in the original SFAS No. 132, which it replaces, but it requires additional disclosures about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. With some exceptions, the revised SFAS No. 132 is effective for financial statements with fiscal years ending after December 15, 2003 and for interim periods beginning after December 15, 2003. We adopted the provisions of this statement as of December 31, 2003 and revised the disclosures for its postretirement benefit plans accordingly. See Note 13 to the Consolidated Financial Statements.

FIN 46 was issued in January 2003. FIN 46 addresses consolidation of variable interest entities ("VIEs") to which the usual condition for consolidation described in Accounting Research Bulletin No. 51, "Consolidated Financial Statements," does not apply because the VIEs have no voting interests or otherwise are not subject to control through ownership of voting interests. It requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The primary beneficiary of a VIE is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. We adopted FIN 46 for the trusts discussed in Note 12 as of July 1, 2003. The trusts, which are special purpose entities, were consolidated into our financial statements as of that date in accordance with the provisions of FIN 46 that were in effect at that time.

In December 2003, the FASB issued a revised version of FIN 46 ("FIN 46-R") that establishes the effective dates for public entities to apply FIN 46 and FIN 46-R based on the nature of the VIE and the date on which the public company became involved with the VIE. In general, a public entity that is not a small business issuer shall apply FIN 46-R to all VIEs no later than the end of the first reporting period ending after March 15, 2004. We are currently analyzing our franchisee relationships (see Note 1) in accordance with FIN 46 and FIN 46-R to determine if any or all are VIEs. We believe that, if consolidation were to occur, it would not have a material impact on our net earnings.

On January 12, 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" in response to a new law regarding prescription drug benefits under Medicare ("Medicare Part D") as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Currently, SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires that changes in relevant law be considered in current measurement of postretirement benefit costs. However, certain accounting issues related to the federal subsidy remain unclear and significant uncertainties may exist that impair a plan sponsor's ability to evaluate the direct effects of the new law and the effects on plan participants' behavior and healthcare costs. Due to these uncertainties, FSP No. 106-1 provides plan sponsors with an opportunity to elect to defer recognizing the effects of the new law in accounting for its retiree health care benefit plans under SFAS No. 106 and to provide related disclosures until authoritative guidance from the FASB on the accounting for the federal subsidy is issued and clarification of other uncertainties is resolved. We have elected to defer recognition while evaluating the new law and the pending issuance of authoritative guidance and their effect, if any, on our financial position, results of operations and financial statement disclosure. Therefore, any measures of the accumulated postretirement benefit obligation or the net periodic postretirement benefit cost do not reflect the effects of the new law, and pending authoritative guidance could require that we change previously reported information.

Quantitative and Qualitative Disclosure About Market Risk

The following discussion summarizes the financial and derivative instruments we held as of December 31, 2003. These instruments

are sensitive to changes in interest rates, foreign exchange rates and equity prices. From time to time, we use interest-rate swaps to manage the primary market exposures associated with underlying liabilities and anticipated transactions. We use these instruments to reduce risk by essentially creating offsetting market exposures. In addition, our two yen-denominated loans effectively serve as an economic hedge of our exposure to yen-dollar currency fluctuations resulting from our significant yen-based royalty from SEJ. We do not leverage the instruments we hold, and we hold the instruments for purposes other than trading. In the normal course of business, we also face risks that are either nonfinancial or nonquantifiable, such as country risk, credit risk and legal risk, and we have not addressed these risks in this discussion.

Interest-Rate Risk Management

We enter into interest-rate swaps to achieve the levels of variable and fixed-rate debt approved by senior management. Under the interest-rate swaps, we agree with other parties to exchange the difference between fixed-rate and floating-rate interest amounts on a quarterly basis. We had one outstanding interest-rate swap at December 31, 2003, with a negative fair value of $3.1 million. The fair value represents the estimated amount we would have paid if we had chosen to terminate the swap as of December 31, 2003. The swap expired in February 2004. We have no other interest-rate swaps in place. See Note 11 to the Consolidated Financial Statements.

As of December 31, 2003, approximately 36% of our debt contained floating rates that will be impacted by changes in interest rates. The weighted-average interest rate for such debt, including the impact of the interest-rate swap agreement, was 3.3% for the year ended December 31, 2003, as compared to 4.1% for the year ended December 31, 2002.

Foreign-Exchange Risk Management

Our $52.0 million of royalty income in 2003 was impacted by fluctuating exchange rates. Approximately 39% of such royalties were from area license agreements with SEJ. Although SFAS No. 133 nullified the hedge accounting treatment we were applying to the SEJ royalty and our yen-denominated loans, we continue to have an economic hedge by using the SEJ royalty receipts to make principal and interest payments on our yen-denominated loans. However, since January 1, 2001, we have adjusted the balance of the yen loans at each reporting date to reflect the current Japanese yen to U.S. dollar exchange rate, and the resulting foreign currency exchange gain or loss is recognized in earnings. Based on our yen-denominated debt balance as of December 31, 2003, a one-point increase or decrease in the Japanese yen to U.S. dollar exchange rate would result in an increase or decrease in pretax earnings of approximately $1.3 million. See "– Critical Accounting Policies and Estimates – Yen Loans" and Notes 1 and 9 to the Consolidated Financial Statements.

In addition, we are exposed to fluctuating exchange rates on the portion of our royalties earned in foreign currencies that are not attributable to our license agreement with SEJ, but we do not believe future risk is material based on current estimates. We also have certain wholly or partially owned foreign subsidiaries and are susceptible to exchange-rate risk on earnings from these subsidiaries; based on current estimates, however, we do not consider future foreign-exchange risk to be material.

Equity-Price Risk Management

We hold equity securities of other companies. We classify these securities as available for sale and carry them on our consolidated balance sheet at fair value. At December 31, 2003, we held shares of Affiliated Computer Services, Inc. common stock (the "ACS shares"), which had no cost basis but had a fair value of $3.2 million. We obtained the ACS shares in 1988 as part of our mainframe data processing contract with ACS. At that time, ACS was a privately held start-up company. Accordingly, the stock was valued with no cost.

Changes in fair value are recognized as other comprehensive earnings, net of tax, as a separate component of shareholders' equity.

Consolidated Balance Sheets

December 31	2002	2003
(Dollars in thousands, except share data)		
ASSETS		
Current assets:		
Cash and cash equivalents	$ 82,423	$ 88,129
Cash for Vcom kiosks	38,342	96,298
Total cash and cash equivalents	120,765	184,427
Accounts receivable	248,483	225,260
Inventories	114,091	105,507
Other current assets	140,837	159,904
Total current assets	624,176	675,098
Property and equipment	2,175,360	2,407,583
Goodwill and other intangible assets	140,490	140,412
Other assets	124,299	125,810
Total assets	$ 3,064,325	$3,348,903
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 260,978	$ 270,747
Accrued expenses and other liabilities	457,623	531,700
Long-term debt due within one year	48,609	39,828
Total current liabilities	767,210	842,275
Deferred credits and other liabilities	386,995	431,116
Senior Subordinated Notes due to SEJ	—	400,000
Other long-term debt	1,366,623	1,035,490
Convertible quarterly income debt securities	380,000	300,000
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.0001 par value; 1,000,000,000 shares authorized; 104,977,302 and 111,834,262 shares issued and outstanding	10	11
Additional capital	1,168,182	1,251,428
Accumulated deficit	(990,107)	(926,013)
Unearned compensation	(1,068)	(796)
Accumulated other comprehensive earnings (loss)	(13,520)	15,392
Total shareholders' equity	163,497	340,022
Total liabilities and shareholders' equity	$ 3,064,325	$3,348,903

See notes to consolidated financial statements.

Consolidated Statements of Earnings

Years Ended December 31	2001	2002	2003
(Dollars in thousands, except per-share data)	*(Restated)*	*(Restated)*	
REVENUES:			
Merchandise sales	$6,672,029	$7,020,500	$ 7,412,453
Gasoline sales	2,636,634	2,760,576	3,372,279
Net sales	9,308,663	9,781,076	10,784,732
Other income	111,894	102,924	96,984
Total revenues	9,420,557	9,884,000	10,881,716
COSTS AND EXPENSES:			
Merchandise cost of goods sold	4,338,199	4,524,412	4,777,884
Gasoline cost of goods sold	2,382,968	2,506,421	3,045,989
Total cost of goods sold	6,721,167	7,030,833	7,823,873
Franchisee gross profit expense	698,128	742,848	798,002
Operating, selling, general and administrative expenses	1,771,381	1,943,170	2,047,543
Interest expense, net	62,693	64,721	71,318
Total costs and expenses	9,253,369	9,781,572	10,740,736
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	167,188	102,428	140,980
INCOME TAX EXPENSE	65,203	40,971	53,572
EARNINGS FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	101,985	61,457	87,408
LOSS ON DISCONTINUED OPERATIONS (net of tax benefit of $5,382, $13,694 and $8,011)	(8,418)	(20,541)	(13,070)
CUMULATIVE EFFECT OF ACCOUNTING CHANGE (net of tax benefit of $6,295, $18,759 and $6,550)	(9,847)	(28,139)	(10,244)
NET EARNINGS	$ 83,720	$ 12,777	$ 64,094
NET EARNINGS PER COMMON SHARE:			
Basic			
Earnings from continuing operations before cumulative effect of accounting change	$ .97	$ .59	$ .82
Loss on discontinued operations	(.08)	(.20)	(.12)
Cumulative effect of accounting change	(.09)	(.27)	(.10)
Net earnings	$ .80	$ .12	$ .60
Diluted			
Earnings from continuing operations before cumulative effect of accounting change	$ .90	$ .56	$ .76
Loss on discontinued operations	(.07)	(.18)	(.10)
Cumulative effect of accounting change	(.08)	(.25)	(.08)
Net earnings	$ .75	$ .13	$ .58

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

	Common Stock					Accumulated Other Comprehensive Earnings (Loss)		
(Dollars and shares in thousands)	**Shares**	**Par Value**	**Additional Capital**	**Accumulated Earnings (Deficit)**	**Unearned Compensation**	**Unrealized Gains (Losses)**	**Foreign Currency Translation**	**Shareholders' Equity**
Balance at December 31, 2000	104,768	$10	$1,166,225	$(1,086,604)	$ —	$ 7,127	$(4,652)	$ 82,106
Net earnings				83,720				83,720
Other comprehensive earnings (loss):								
Unrealized gain on equity securities (net of $2,126 deferred taxes)						3,325		3,325
Reclassification adjustments for gains included in net earnings (net of $3,338 deferred taxes)						(5,221)		(5,221)
Unrealized loss related to interest rate swap (net of ($5,478) deferred taxes)						(7,684)		(7,684)
Cumulative effect of accounting change (net of $784 deferred taxes)						702		702
Foreign currency translation							(4,872)	(4,872)
Total other comprehensive loss								(13,750)
Comprehensive loss								69,970
Issuance of stock	41	—	399					399
Balance at December 31, 2001	104,809	10	1,166,624	(1,002,884)	—	(1,751)	(9,524)	152,475
Net earnings				12,777				12,777
Other comprehensive earnings (loss):								
Unrealized loss on equity securities (net of ($49) deferred taxes)						(270)		(270)
Reclassification adjustments for gains included in net earnings (net of $1,195 deferred taxes)						(1,812)		(1,812)
Unrealized gain related to interest rate swap (net of $346 deferred taxes)						92		92
Foreign currency translation							(255)	(255)
Total other comprehensive loss								(2,245)
Comprehensive earnings								10,532
Unearned compensation					(1,068)			(1,068)
Issuance of stock	168	—	1,558					1,558
Balance at December 31, 2002	104,977	10	1,168,182	(990,107)	(1,068)	(3,741)	(9,779)	163,497
Net earnings				64,094				64,094
Other comprehensive earnings (loss):								
Unrealized gain on equity securities (net of $42 deferred taxes)						18		18
Reclassification adjustments for gains included in net earnings (net of $799 deferred taxes)						(1,198)		(1,198)
Unrealized gain related to interest rate swap (net of $5,304 deferred taxes)						6,505		6,505
Unrealized loss related to benefit plan (net of ($156) deferred taxes)						(244)		(244)
Foreign currency translation							23,831	23,831
Total other comprehensive earnings								28,912
Comprehensive earnings								93,006
Unearned compensation					272			272
1998 QUIDS conversion to stock	6,502	1	79,692					79,693
Issuance of stock	355		3,554					3,554
Balance at December 31, 2003	111,834	$11	$1,251,428	$ (926,013)	$ (796)	$ 1,340	$14,052	$340,022

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended December 31	2001	2002	2003
(Dollars in thousands)			
CASH FLOWS FROM OPERATING ACTIVITIES			
Net earnings	$ 83,720	$ 12,777	$ 64,094
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Cumulative effect of accounting change	9,847	28,139	10,244
Depreciation and amortization of property and equipment	246,782	279,807	306,907
Other amortization	20,117	355	220
Deferred income taxes	28,141	20,245	25,338
Noncash interest expense	1,246	1,242	182
Foreign currency net conversion (gain) loss	(13,992)	14,930	11,002
Other noncash (income) expense	(1,013)	(743)	5,119
Gain on debt redemption	—	—	(10,455)
Net loss on property and equipment	12,208	25,085	13,149
Decrease (increase) in accounts receivable	(39,607)	(28,984)	28,825
Decrease (increase) in inventories	(7,660)	438	8,584
(Increase) decrease in other assets	(47,309)	18,024	(14,716)
Increase (decrease) in trade accounts payable and other liabilities	(14,245)	125,432	86,018
Net cash provided by operating activities	278,235	496,747	534,511
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for purchase of property and equipment	(356,902)	(426,234)	(338,251)
Proceeds from sale of property and equipment	11,154	16,515	16,630
Proceeds from sale of domestic securities	8,537	2,996	1,989
Restricted cash	(19,585)	(37,147)	(16,110)
Other	(593)	(418)	90
Net cash used in investing activities	(357,389)	(444,288)	(335,652)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from commercial paper and revolving credit facilities	4,405,780	5,853,757	5,104,368
Payments under commercial paper and revolving credit facilities	(4,328,475)	(5,848,694)	(5,261,717)
Proceeds from issuance of long-term debt	76,602	—	400,000
Principal payments under long-term debt agreements	(76,812)	(40,831)	(400,213)
Increase (decrease) in outstanding checks in excess of cash in bank	(3,410)	(20,637)	19,350
Net proceeds from issuance of common stock	223	51	3,057
Other	(2,333)	(939)	(42)
Net cash (used in) provided by financing activities	71,575	(57,293)	(135,197)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(7,579)	(4,834)	63,662
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	133,178	125,599	120,765
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 125,599	$ 120,765	$ 184,427
RELATED DISCLOSURES FOR CASH FLOW REPORTING			
Interest paid, excluding SFAS No.15 Interest	$ (73,236)	$ (69,641)	$ (70,604)
Net income taxes (paid) refunded	$ (36,503)	$ 13,608	$ (13,125)
Assets obtained by entering into capital leases	$ 22,480	$ 42,536	$ 51,580
1998 Yen Loan principal and interest payments from restricted cash	$ (10,603)	$ (42,399)	$ (16,190)
1998 QUIDS conversion to common stock	$ —	$ —	$ (79,693)

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1. Accounting Policies

Principles of Consolidation – 7-Eleven, Inc. and its subsidiaries ("the Company") is 73.88% collectively owned by IYG Holding Company ("IYG"), Ito-Yokado Co., Ltd. ("IY") and Seven-Eleven Japan Co., Ltd. ("SEJ"). IYG is jointly owned by IY and SEJ, and SEJ is a majority-owned subsidiary of IY. The Company and its franchisees operate approximately 5,800 7-Eleven and other convenience stores in the United States and Canada. Area licensees, or their franchisees, and affiliates operate approximately 20,000 additional 7-Eleven convenience stores in certain areas of the United States, in 15 other countries and in the U.S. territories of Guam and Puerto Rico.

The consolidated financial statements include the accounts of 7-Eleven, Inc. and its subsidiaries. Also included in the consolidated financial statements are the accounts of certain variable interest entities ("VIEs") that the Company consolidated as of July 1, 2003, as a result of adopting the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51," ("FIN 46") (see Notes 9, 12 and 19). Intercompany transactions and account balances are eliminated.

Certain prior-year amounts have been reclassified to conform to the current-year presentation. In 2003, the Company revised its accounting for sales of prepaid phone cards to report revenues net of related costs in conformity with the provisions of Emerging Issues Task Force ("EITF") Issue No. 99-19, "Reporting Revenue Gross Versus Net." As a result of this change, merchandise cost of goods sold amounts of $136.4 million and $155.5 million for the years ended December 31, 2001 and 2002, respectively, have been recorded as a reduction of merchandise sales. Net sales, total revenues, total cost of goods sold and total costs and expenses have also been adjusted by these amounts. The change has no effect on previously reported earnings from continuing operations, net earnings or shareholders' equity.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Such estimates are based on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances. The results of these estimates form the basis of the Company's judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Merchandise sales and cost of goods sold of stores operated by franchisees are consolidated with the results of Company-operated stores. Merchandise sales of stores operated by franchisees are $3.82 billion, $4.03 billion and $4.33 billion from 3,174, 3,276 and 3,338 stores for the years ended December 31, 2001, 2002 and 2003, respectively.

The gross profit of franchise stores is split between the Company and its franchisees. The franchisees' share of the gross profit of franchise stores generally approximates 48% of the merchandise gross profit of the store and is included in franchisee gross profit expense in the accompanying consolidated statements of earnings. The Company's share of the gross profit of franchise stores is its ongoing royalty, generally approximating 52% of the merchandise gross profit of the store, which is charged to the franchisee for the license to use the 7-Eleven operating system and trademarks, for the lease and use of the store premises and equipment, and for continuing services provided by the Company. These services include financing, bookkeeping, advertising, business counseling and other services. The Company also provides financing of the franchisee store inventory and other operating items (see Note 2), which are collateralized by the store inventory. The Company believes that its maximum exposure to loss as a result of its relationship with the franchisees is $82.1 million, which is the amount of the accounts and notes receivable from franchisees currently reflected in the accompanying consolidated balance sheets as of December 31, 2003.

With regard to gasoline sales, the franchise agreements in most instances require the Company to pay the franchisee one cent per gallon sold as compensation for measuring and reporting deliveries of gasoline, conducting pricing surveys of competitors, changing the price displays and cleaning the service areas. The Company has implemented a non-contractual policy under which it pays its franchisees the greater of (a) 1.5 cents per gallon or (b) either 20%, 24% or 25% of the gasoline gross profit, depending on when the store was franchised. The Company can change this policy at any time but has agreed to keep the policy in place for all of 2004. These amounts are also included in franchisee gross profit expense in the accompanying consolidated statements of earnings.

As of December 31, 2003, the Company's franchisees were operating under the provisions of the franchise agreements discussed above, but the Company has finalized a new franchise agreement that the Company is beginning to use during 2004. The new agreement revises the gross profit split between the Company and its franchisees (creating, in most cases, a 50/50 split between the Company and the franchisee) and provides for an advertising fee to be paid by the franchisee to the Company for certain advertising

costs incurred by the Company. In addition, the new agreement includes a provision requiring that a minimum percentage of the franchisee's total purchases must be from the Company's recommended vendors. The Company does not anticipate that the new agreement will have a material adverse impact on the Company's or the franchisees' results of operations.

Sales by stores operated under domestic and foreign area license agreements are not included in consolidated revenues. All fees or royalties arising from such agreements are included in other income. Initial fees, which have been immaterial, are recognized when the services required under the agreements are performed.

Operating Segment – The Company operates in a single operating segment – the operating, franchising and licensing of convenience food stores, primarily under the 7-Eleven name.

The Company does not rely on any major customers as a source of revenue. Excluding area license royalties, which are included in other income as noted above, the Company's operations are concentrated in the United States and Canada. Net sales from Canadian operations approximated 8% of the Company's total net sales for the years ended December 31, 2001, 2002 and 2003. Approximately 5% and 6% of the Company's long-lived assets for the years ended December 31, 2002 and 2003, respectively, are located in Canada.

Revenues – Revenues from the Company's two major product categories, merchandise and gasoline, are recognized at the point of sale. Based on the total dollar volume of store purchases, management estimates that the percentages of its convenience store merchandise sales by principal product category for the last three years were as follows:

Product Categories

Years Ended December 31	2001	2002	2003
Tobacco	27.0%	28.1%	29.4%
Beverages	23.0%	23.0%	23.1%
Beer/Wine	11.3%	11.2%	11.4%
Candy/Snacks	10.9%	10.9%	10.5%
Non-Foods	8.0%	7.6%	7.0%
Fresh Foods	6.6%	6.7%	7.2%
Dairy	4.8%	4.5%	4.4%
Other	4.9%	4.6%	3.6%
Total Product Sales	96.5%	96.6%	96.6%
Services	3.5%	3.4%	3.4%
Total Merchandise Sales	100.0%	100.0%	100.0%

Services include lottery, ATM, prepaid cards and money order service fees/commissions for which there are little, if any, costs included in merchandise cost of goods sold. Amounts previously reported in a Prepaid Products category have been reclassified to the Services or the Other category.

Other Income – Other income is primarily area license royalties, franchise fee income and Vcom fees. The area license royalties were $84.8 million, $71.6 million and $52.0 million and include amounts from area license agreements with SEJ of $60.9 million, $43.2 million and $20.1 million for the years ended December 31, 2001, 2002 and 2003, respectively. Beginning in August 2002, royalty payments from SEJ were reduced by approximately 70% in accordance with the terms of the license agreement.

The Company's traditional franchise agreements typically have a 10-year term, or the term of the Company's lease if shorter than 10 years. In 2004, the Company is beginning to use a new franchise agreement with a term of 15 years. The Company will offer the new agreement to all existing franchisees, even if the franchisee's current agreement has not yet expired, and all new franchisees. Under both the traditional agreement and the new agreement, the initial franchise fees are generally calculated based on gross profit dollar experience for the store or market area. These fees cover certain costs including training, an allowance for lodging for the trainees and other costs relating to the franchising of the store. The Company defers the recognition of these fees until its obligations under the agreement are completed and a 90-day franchisee termination and refund period has passed. Franchise fees recognized in earnings were $18.3 million, $20.0 million and $17.9 million for the years ended December 31, 2001, 2002 and 2003, respectively.

The Company has a program in place to finance the franchise fee for a qualifying franchisee. As of December 31, 2002 and 2003, the Company had $13.5 million and $9.4 million of outstanding notes receivable from franchisees, of which $4.2 million and $3.8 million were classified as current for the respective years (see Note 2).

The Company defers the recognition of proceeds received in advance of satisfying revenue recognition criteria. These funds, which primarily relate to the Company's Vcom agreements, are recognized as revenue when earned, as specified by the substance of the applicable agreement (see Notes 7 and 8).

Operating, Selling, General and Administrative Expenses ("OSG&A") – Store labor, occupancy expense and corporate expenses are the primary components of OSG&A. Advertising costs, also included in OSG&A, generally are charged to expense as incurred and were $32.9 million, $38.9 million and $44.9 million for the years ended December 31, 2001, 2002 and 2003, respectively.

Interest Expense – Interest expense is net of interest income and capitalized interest. Interest income was $13.4 million, $9.6 million and $8.2 million, and capitalized interest was $4.2 million, $3.8 million and $4.4 million for the years ended December 31, 2001, 2002 and 2003, respectively.

Income Taxes – Income taxes are determined using the liability method, where deferred tax assets and liabilities are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets include tax carryforwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Cash and Cash Equivalents – The Company considers all highly liquid investment instruments purchased with maturities of three months or less to be cash equivalents. Cash and cash equivalents include temporary cash investments of $5.1 million and $11.1 million at December 31, 2002 and 2003, respectively, stated at cost, which approximates market.

The Company utilizes a cash management system under which a book cash overdraft exists for the Company's primary disbursement accounts. These overdrafts represent uncleared checks in excess of cash balances in bank accounts at the end of the reporting period. The Company transfers cash on an as-needed basis to fund clearing checks (see Note 7).

The Company separately maintains cash in connection with its proprietary self-service kiosks, Vcom. This cash, which is presented separately on the accompanying consolidated balance sheets, represents cash in Vcom kiosks for use in daily transactions as well as cash in vaults waiting to be transferred to the kiosks or to banks.

Inventories – Inventories are stated at the lower of cost or market. Cost is generally determined by the LIFO method for company-operated stores in the United States and by the FIFO method for stores in Canada.

Depreciation and Amortization – Depreciation of property and equipment is based on the estimated useful lives of these assets using the straight-line method. Acquisition and development costs for significant business systems and related software for internal use are capitalized and are depreciated or amortized on a straight-line basis. Included in depreciation and amortization of property and equipment in the accompanying consolidated statements of cash flows is software amortization expense of $33.0 million, $39.2 million and $49.5 million for the years ended December 31, 2001, 2002 and 2003, respectively. Amortization of capital lease assets and leasehold improvements is based on the remaining terms of the leases or the estimated useful lives, whichever is shorter.

The following table summarizes the years over which significant assets are generally depreciated or amortized:

	Years
Buildings	25
Leasehold improvements	3 to 20
Equipment	3 to 10
Software and other intangibles	3 to 10

Notes to Consolidated Financial Statements

Store Closings and Asset Impairment – The Company writes down property and equipment of stores it is closing to estimated net realizable value at the time management commits to a plan to close such stores and begins to actively market the store. If the stores are leased, the Company accrues for related future estimated rent and other expenses if the expenses are expected to exceed estimated sublease rental income. The Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," effective January 1, 2003, and as a result, for leased stores, the Company will accrue for related future estimated rent and other expenses at the time the store ceases operations if the expenses are expected to exceed estimated sublease rental income. Prior to 2003, the Company accrued for related future estimated rent and other expenses when it committed to a plan to close the stores. The Company bases the estimated net realizable value of property and equipment on its experience in utilizing and/or disposing of similar assets and on estimates provided by its own and/or third-party real estate experts. The Company also uses its experience in subleasing similar property to estimate future sublease income.

The results of operations of certain owned and leased stores are presented as discontinued operations in the accompanying consolidated statements of earnings in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (see Note 5). The results of operations of owned stores are presented as discontinued operations beginning in the quarter in which management commits to a plan to close the related store and actively markets the store. The results of operations of a leased store are presented as discontinued operations beginning in the quarter in which the related store ceases operations. The results of operations include related write-downs of stores to estimated net realizable value and accruals for future estimated rent and other expenses in excess of estimated sublease rental income. The Company does not allocate interest expense to discontinued operations.

The Company's long-lived assets are reviewed for impairment and written down to fair value whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In addition, the Company also conducts an annual impairment test of its goodwill and intangible assets with indefinite lives in accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" (see Note 6). The impairment test for goodwill is comprised of two steps. Step one compares the fair value of the reporting unit with its carrying amount, including goodwill. If the carrying amount exceeds the fair value, then goodwill is impaired and step two is required to measure the amount of impairment loss. Step two compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount is greater than the implied fair value of the goodwill, an impairment loss is recognized for the excess.

The impairment test for intangible assets with indefinite lives consists of a comparison of the fair value of the intangible asset with its carrying amount. Fair value is determined by calculating the present value of future estimated revenues. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized for the excess.

Asset Retirement Obligations – The Company records an estimated liability for the future cost to remove an underground storage tank in accordance with the provisions of SFAS No. 143, "Asset Retirement Obligations," (see Note 8) and recognizes the cost over the estimated useful life of the storage tank. A liability for the fair value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset is recorded at the time an underground storage tank is installed. The Company amortizes the amount added to property and equipment and recognizes accretion expense in connection with the discounted liability over the estimated remaining life of the respective underground storage tank.

Stock-Based Compensation – The 1995 Stock Incentive Plan (the "Stock Incentive Plan") provides for the granting of stock options, stock appreciation rights, performance shares, restricted stock, restricted stock units, bonus stock and other forms of stock-based awards and authorizes the issuance of up to 11.2 million shares over a 10-year period to certain key employees and officers of the Company (see Note 15). Included in the shares is an additional 3.0 million shares authorized for issuance by the Company's Board of Directors and approved by the Company's shareholders during 2003. As of December 31, 2003, 3.4 million shares were available for future issuance under the Stock Incentive Plan.

All options granted in 2001, 2002 and 2003 were granted at an exercise price that was equal to the fair market value on the date of grant. The options granted vest annually in five equal installments beginning one year after grant date with possible acceleration thereafter based on certain improvements in the price of the Company's common stock. Vested options are exercisable within 10 years of the date granted.

The fair value of each option grant under the Stock Incentive Plan is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for the options granted: for each year presented, expected life of five years and no dividend yields, combined with risk-free interest rates of 5.09%, 4.67% and 2.65% and expected volatility of 67.23%, 67.54% and 64.98% for options granted in the years ended December 31, 2001, 2002 and 2003, respectively.

Notes to Consolidated Financial Statements

In 2003, the Company's shareholders approved an amendment to the Stock Compensation Plan for Non-Employee Directors (the "Non-Employee Directors Plan") (see Note 15), which provides for the issuance of stock options to the Company's independent directors. Under the amended Non-Employee Directors Plan, the Company granted stock options in May 2003 at an exercise price that was equal to the fair market value on the date of grant.

The Company has recognized no compensation expense for its stock options as it is accounting for both the Stock Incentive Plan and the Non-Employee Directors Plan under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." If compensation expense had been determined based on the fair value at the grant date for awards under these plans consistent with the method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net earnings and net earnings per common share would have been reduced to the pro forma amounts indicated in the following table:

Years Ended December 31	**2001**	**2002**	**2003**
	(Dollars in thousands, except per-share data)		
Net earnings as reported	$83,720	$12,777	$64,094
Add: Stock-based compensation expense included in reported net earnings, net of tax	115	268	1,742
Less: Total stock-based compensation expense determined under the fair-value-based method for all stock-option awards, net of tax	(4,967)	(4,425)	(6,439)
Pro forma net earnings	$78,868	$ 8,620	$59,397
Net earnings per common share as reported			
Basic	$ .80	$ .12	$ .60
Diluted	.75	.13	.58
Pro forma net earnings per common share			
Basic	$ .75	$ .08	$ .56
Diluted	.71	.10	.55

Insurance – The Company has established self-insurance and predetermined-deductible programs to cover certain insurable risks consisting primarily of employee healthcare, physical loss to property, business interruptions resulting from such loss, workers' compensation and comprehensive general liability. Third-party insurance coverage above predetermined deductibles is obtained for property and casualty exposures as well as those risks required to be insured by law or contract. Provisions for losses expected under the Company's insurance programs are recorded based on independent actuarial estimates of the aggregate liabilities for claims incurred.

Environmental – The Company accrues for the estimated future costs related to remediation activities at existing and previously operated gasoline storage sites and other operating and nonoperating properties where releases of regulated substances have been detected. Estimates of the anticipated future costs for remediation activities at such sites are based on the Company's prior experience with remediation sites and consideration of factors such as the condition of the site contamination, location of tank sites and experience with contractors that perform environmental assessment and remediation work. The reserve is determined on a site-by-site basis, and a liability is recorded for remediation activities when it is probable that corrective action will be taken and the cost of the remediation activities can be reasonably estimated.

A portion of the environmental expenditures incurred for remediation activities is eligible for reimbursement under state trust funds and reimbursement programs. A receivable is recorded for estimated probable refunds when the related liability is recorded. The amount of the receivable is based on the Company's historical collection experience with the specific state fund (or other state funds), the financial status of the state fund and the Company's priority ranking for reimbursement from the state fund. The receivable is discounted if the amount relates to remediation activities that have already been completed (see Note 14).

Notes to Consolidated Financial Statements

Note 2. Accounts Receivable

December 31	2002	2003
	(Dollars in thousands)	
Trade accounts receivable	$ 58,388	$ 83,656
Vendor receivables	96,675	52,994
Franchisee accounts and notes receivable	78,850	76,439
Environmental cost reimbursements – see Note 14	6,870	5,819
SEJ royalty receivable	1,575	1,772
Federal income tax receivable	2,935	4,012
Other accounts receivable	7,429	3,991
	252,722	228,683
Allowance for doubtful accounts	(4,239)	(3,423)
	$ 248,483	$ 225,260

Note 3. Inventories

December 31	2002	2003
	(Dollars in thousands)	
Merchandise	$ 78,495	$ 70,286
Gasoline	35,596	35,221
	$ 114,091	$ 105,507

Inventories stated on the LIFO basis that are included in inventories in the accompanying consolidated balance sheets were $50.0 million and $42.9 million for merchandise and $28.7 million and $27.2 million for gasoline at December 31, 2002 and 2003, respectively. These amounts are less than replacement cost by $40.9 million and $39.0 million for merchandise and $10.8 million and $13.0 million for gasoline at December 31, 2002 and 2003, respectively.

For the years ended December 31, 2001, 2002 and 2003, certain inventory quantities were reduced resulting in a liquidation of LIFO inventory layers recorded at costs that were lower than the costs of current purchases. The effect of these reductions was a decrease in cost of goods sold of $2.6 million, $754,000 and $3.6 million, respectively.

Note 4. Other Current Assets

December 31	2002	2003
	(Dollars in thousands)	
Prepaid expenses	$ 49,604	$ 61,774
Deferred tax assets – see Note 16	49,819	46,266
Advances for lottery and other tickets	26,846	29,062
Assets held for sale – see Note 5	9,573	13,325
Restricted cash – see Note 9	4,094	8,508
Other	901	969
	$ 140,837	$ 159,904

Notes to Consolidated Financial Statements

Note 5. Property and Equipment

December 31	2002	2003
	(Dollars in thousands)	
Cost		
Land	$ 518,456	$ 561,475
Buildings	452,695	509,814
Leasehold improvements	1,488,103	1,664,707
Equipment	1,370,311	1,511,714
Software (includes $47,428 and $63,052 of software development)	340,932	396,516
Construction in process	66,149	58,117
	4,236,646	4,702,343
Accumulated depreciation and amortization (includes $141,859 and $187,299 related to software)	(2,061,286)	(2,294,760)
	$ 2,175,360	$ 2,407,583

The Company accounts for stores that have closed subsequent to January 1, 2001, as discontinued operations under the provisions of SFAS No. 144 (see Note 1). The stores presented as discontinued operations had total revenues of $337.1 million, $210.9 million and $93.4 million and pretax losses of $13.8 million, $34.2 million and $21.1 million for the years ended December 31, 2001, 2002 and 2003, respectively. Included in the loss on discontinued operations are losses on disposal of $3.2 million (net of tax benefit of $2.1 million), $13.9 million (net of tax benefit of $9.2 million) and $6.2 million (net of tax benefit of $3.8 million) for the years ended December 31, 2001, 2002 and 2003, respectively. The losses on disposal include write-downs of stores to net realizable value, anticipated future rent and other expenses in excess of related estimated sublease income as well as gains and losses on sales of stores. As of December 31, 2002 and 2003, the carrying amounts of the remaining owned properties are included in other current assets in the accompanying consolidated balance sheets as assets held for sale (see Note 4). These properties are being actively marketed.

Note 6. Goodwill and Other Intangible Assets

December 31	2002	2003
	(Dollars in thousands)	
SEJ license royalty intangible	$ 89,420	$ 89,420
Other license royalty intangibles	15,836	15,836
Goodwill	30,009	30,244
Other intangibles	5,225	4,912
	$140,490	$140,412

Effective January 1, 2002, the Company adopted the provisions of SFAS No. 142 (see Note 1), which addresses financial accounting and reporting for acquired goodwill and other intangible assets. The statement eliminates amortization of goodwill and intangible assets with indefinite lives and requires a transitional impairment test of these assets within six months of the date of adoption and an annual impairment test thereafter and in certain circumstances. The Company completed the transitional impairment test of goodwill and intangible assets with indefinite lives as of January 1, 2002, and the annual impairment tests of these assets as of September 30, 2002 and 2003, and there was no evidence of impairment in the tests. The annual impairment test will be conducted each year as of the end of the third quarter.

Notes to Consolidated Financial Statements

The following is a reconciliation of both the net earnings and the basic and diluted net earnings per common share between the amounts reported by the Company and the adjusted amounts reflecting the new accounting requirements for the periods presented (in thousands, except per-share data):

Years Ended December 31	2001	2002	2003
Net earnings as reported	$83,720	$12,777	$64,094
Add back:			
Goodwill amortization, net of tax	509	—	—
Indefinite-lived intangibles amortization, net of tax	11,545	—	—
Net earnings as adjusted	$95,774	$12,777	$64,094
Basic earnings per common share as reported	$ .80	$ .12	$ .60
Add back:			
Goodwill amortization, net of tax	—	—	—
Indefinite-lived intangibles amortization, net of tax	.11	—	—
Basic earnings per common share as adjusted	$ .91	$ .12	$ .60
Diluted earnings per common share as reported	$ .75	$ .13	$ .58
Add back:			
Goodwill amortization, net of tax	—	—	—
Indefinite-lived intangibles amortization, net of tax	.09	—	—
Diluted earnings per common share as adjusted	$ .84	$ .13	$ .58

Note 7. Accrued Expenses and Other Liabilities

December 31	2002	2003
	(Dollars in thousands)	
Insurance	$ 21,677	$ 44,006
Compensation	89,069	82,179
Taxes	62,990	69,032
Lotto, lottery and other tickets	52,050	54,344
Other accounts payable	52,709	82,443
Environmental costs – see Note 14	19,407	19,387
Profit sharing – see Note 13	14,480	15,537
Interest	6,930	14,284
Book overdrafts payable – see Note 1	49,084	68,434
Deferred income – see Notes 1 and 8	22,815	12,725
Other current liabilities	66,412	69,329
	$457,623	$531,700

The Company initiated cost reduction efforts in 2002 to streamline administrative functions and consolidate divisions, resulting in the elimination of approximately 125 positions. The results of operations for the year ended December 31, 2002, include a $5.6 million charge to OSG&A expense for severance costs. As of December 31, 2002 and 2003, $2.2 million and $1.2 million, respectively, were included in accrued expenses and other liabilities in the accompanying consolidated balance sheets relating to unpaid severance costs.

Note 8. Deferred Credits and Other Liabilities

December 31	2002	2003
	(Dollars in thousands)	
Deferred income taxes	$118,137	$155,303
Underground gasoline storage tanks	52,463	54,325
Insurance	49,737	42,792
Post-employment benefits – see Note 13	46,393	46,906
Straight-line rent accrual	41,807	36,433
Deferred income – see Notes 1 and 7	27,264	39,321
Environmental	21,364	23,182
Other	29,830	32,854
	$386,995	$431,116

The estimated liability for the removal of underground gasoline storage tanks is based on the Company's historical experience in removing these tanks, estimated tank useful lives, external estimates as to the cost to remove the tanks in the future and federal and state regulatory requirements. The liability at both December 31, 2002 and 2003 is discounted using a credit-adjusted risk-free rate of approximately 8%. Revisions to the liability could occur due to changes in tank removal costs or tank useful lives, or if federal or state regulators enact new requirements on the removal of such tanks.

Upon adoption of SFAS No. 143 in 2002 (see Note 1), the Company recorded a discounted liability of $53.6 million, increased net property and equipment by $6.7 million and recognized a one-time cumulative effect charge of $28.1 million (net of deferred tax benefit of $18.8 million). Pro forma effects on earnings from continuing operations before cumulative effect of accounting change for the year ended December 31, 2001, assuming the adoption of SFAS No. 143 as of January 1, 2001, were not material to net earnings or earnings per share. The pro forma liability as of January 1, 2001, would have been approximately $52 million.

A reconciliation of the Company's liability for the removal of its underground gasoline storage tanks is as follows (dollars in thousands):

Years Ended December 31	2002	2003
Beginning balance at January 1	$ 53,648	$ 54,403
Liabilities incurred	561	1,165
Liabilities settled	(2,641)	(3,110)
Accretion expense	2,835	3,219
Revisions to estimate	—	448
	$ 54,403	$ 56,125

Of the total liability recorded in the accompanying consolidated balance sheets as of December 31, 2002 and 2003, $52.5 million and $54.3 million, respectively, is included in deferred credits and other liabilities and the remainder is included in accrued expenses and other liabilities.

The Company received $21.1 million, $16.0 million and $28.8 million in fees from Vcom partners in 2001, 2002 and 2003, respectively. The Company recognized $7.0 million and $3.0 million of such fees as an offset to costs associated with Vcom in OSG&A expense in 2001 and 2002, respectively; no fees were offset in this manner in 2003. The Company recognized $927,000, $3.7 million and $20.8 million of fees in other income in 2001, 2002 and 2003, respectively. As of December 31, 2002 and 2003, $22.5 million and $30.5 million, respectively, of the fees received had not been recognized in earnings and are included in deferred income. Of the total amounts recorded, $12.3 million and $5.4 million are included in accrued expenses and other liabilities and the remainder in deferred credits and other liabilities as of December 31, 2002 and 2003, respectively. The Company amortizes substantially all fee income over the term of the applicable agreement.

Note 9. Debt

December 31	2002	2003
	(Dollars in thousands)	
Senior Subordinated Notes due to SEJ	$ —	$ 400,000
Revolving Credit Facility	—	—
Commercial paper	476,396	318,633
5% First Priority Senior Subordinated Debentures	251,258	—
4½% Second Priority Senior Subordinated Debentures (Series A)	118,910	—
4% Second Priority Senior Subordinated Debentures (Series B)	19,627	—
Yen Loans	144,411	144,368
7½% Cityplace Term Loan due 2005	214,205	207,886
Notes payable to senior lenders (see Note 12)	—	178,069
Capital lease obligations	187,991	224,537
Other	2,434	1,825
	1,415,232	1,475,318
Less: Senior Subordinated Notes due to SEJ	—	400,000
Long-term debt due within one year	48,609	39,828
	$1,366,623	$1,035,490

Notes to Consolidated Financial Statements

Senior Subordinated Notes due to SEJ – In January 2003, the Company entered into a note purchase agreement with SEJ that authorizes the issuance and sale of up to $400 million aggregate principal amount of Senior Subordinated Notes due 2010 ("SEJ Notes"), which were issued by the Company and purchased by SEJ in multiple tranches during 2003. The Company is required to repay the SEJ Notes in eight equal semiannual installments beginning July 2006 and ending January 2010, and interest payments on the unpaid balance of the SEJ Notes are required semiannually beginning January 2003. The SEJ Notes are subordinate to all obligations outstanding under the Company's Credit Agreement.

On January 10, 2003, the Company received $100 million from SEJ under the note purchase agreement; the interest rate on this tranche is stated at 3.41%. On July 9, 2003, the Company received the remaining $300 million from SEJ under the note purchase agreement in three equal payments of $100 million; the interest rate on these tranches is stated at 3.01%, 3.34% and 3.71%, respectively. The accompanying financial statements include interest payable of $5.8 million on the SEJ Notes as of December 31, 2003, as well as interest expense of $8.1 million for the year ended December 31, 2003.

In July 2003, the Company used a portion of the proceeds of the SEJ Notes to retire $239.3 million principal amount of its 5% First Priority Senior Subordinated Debentures, $111.4 million principal amount of its 4½% Second Priority Senior Subordinated Debentures (Series A) and $18.5 million principal amount of its 4% Second Priority Senior Subordinated Debentures (Series B) (collectively, the "Debentures"). Primarily as a result of including interest under SFAS No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructuring" ("SFAS No. 15 Interest") in the carrying amount of the retired debt, the Company recognized a pretax gain of $10.5 million in 2003. The gain was recorded in OSG&A.

The Debentures, which were retired in July 2003, were accounted for in accordance with SFAS No. 15 and were recorded at an amount equal to the future undiscounted cash payments, both principal and SFAS No. 15 Interest. Accordingly, no interest expense was recognized over the life of these securities, and cash interest payments were charged against the recorded amount of such securities.

Revolving Credit Facility – The Company is obligated to a group of lenders under a $200 million unsecured revolving credit agreement ("Credit Agreement"). The Credit Agreement includes a sublimit of $150 million for letters of credit. The revolving credit facility expires in January 2006. At December 31, 2003, outstanding letters of credit under the facility totaled $113.8 million, which reduced available funds under the revolving credit facility to $86.2 million.

Interest on borrowings under the revolving credit facility is generally payable quarterly and is based on a variable rate equal to the administrative agent bank's base rate (4.0% at December 31, 2003) or, at the Company's option, at a rate equal to a reserve-adjusted Eurodollar rate plus a margin determined by the Company's credit ratings for senior long-term indebtedness. As of December 31, 2003, the one-month Eurodollar rate was 1.12% and the applicable margin rate was 0.725%.

A facility fee of 0.15% per year is charged on the aggregate amount of the revolving credit facility. In addition, if the average outstanding balance under the facility is greater than or equal to two-thirds of the available borrowings under the facility, a utilization fee is charged on the average outstanding principal amount of loans and the undrawn face amount of the letters of credit. The utilization fee is also tied to the Company's senior long-term indebtedness as described above, and was 0.375% as of December 31, 2003. Since the inception of the Credit Agreement, the Company has not met or exceeded the two-thirds utilization threshold and has therefore not been required to pay the utilization fee. All fees are paid quarterly.

The Credit Agreement, as amended in 2002, contains various financial and operating covenants that require, among other things, the maintenance of certain financial ratios including interest and rent coverage, consolidated total indebtedness and consolidated senior indebtedness to earnings before interest, income taxes, depreciation, amortization and the interest component of rent expense on certain lease facilities. The Credit Agreement also contains various covenants that, among other things (a) limit the Company's ability to incur or guarantee indebtedness or other liabilities other than under the Credit Agreement; (b) limit the Company's ability to engage in asset sales and sale/leaseback transactions; (c) limit the types of investments the Company can make; and (d) limit the Company's ability to pay cash dividends or redeem or prepay principal and interest on any subordinated debt.

Commercial Paper – The availability of borrowings under the Company's commercial paper facility is $650 million. The outstanding principal amount, net of discount, was $476.4 million and $318.6 million as of December 31, 2002 and 2003, respectively. This was classified as long-term debt since the Company intends to maintain at least these amounts outstanding during the next year. Such debt is unsecured and is fully and unconditionally guaranteed by IY. IY has agreed to continue its guarantee of all commercial paper issued through 2005. While it is not anticipated that IY would be required to perform under its commercial paper guarantee, in the event IY makes any payments under the guarantee, the Company and IY have entered into an agreement by which the Company is required to reimburse IY subject to certain restrictions in the Credit Agreement. The restrictions principally specify

that no reimbursements can be made until one year after repayment in full of amounts outstanding under the Credit Agreement. The weighted-average interest rate was 1.5% and 1.1% on commercial paper borrowings outstanding at December 31, 2002 and 2003, respectively.

Yen Loans – The Company has monetized its future royalty payments from SEJ, its area licensee in Japan, through fixed-rate yen-denominated loans that are nonrecourse to the Company as to principal and interest. These loans, which are referred to as the "1998 Yen Loan" and the "2001 Yen Loan," are collateralized by the Japanese trademarks and a pledge of the future area license royalty payments from SEJ.

As of December 31, 2003, the principal balance on the 1998 Yen Loan was 5.5 billion yen or $51.2 million at the exchange rate in effect on that date (107.37). The 1998 Yen Loan has an interest rate of 2.3%, and principal and interest are paid semiannually from the SEJ area license royalty income. Based on current royalty income projections, the final payment will be made in 2006.

As of December 31, 2003, the principal balance on the 2001 Yen Loan was 10 billion yen or $93.1 million at the exchange rate in effect on that date (107.37). The 2001 Yen Loan has an interest rate of 1.8%, and principal and interest are payable from the SEJ area license royalty income. Semiannual principal payments commence April 2007, and semiannual interest payments began October 2002 in accordance with the loan agreement. Interest expense exceeds interest paid until commencement of principal payments in 2007, at which time interest paid will exceed interest expense. The excess interest is added to the principal balance and interest is accrued thereon. Based on current royalty income projections, the final payment will be made in 2011.

The 1998 Yen Loan and the 2001 Yen Loan were funded by entities formed by the lenders. The Company has no management control or equity interest in these entities. The Company's obligation to the entities is known (i.e., principal and interest payments as defined in the loan agreements), and the Company has no contingent obligations. The entities enable lenders to convert a portion of the Company's fixed-rate debt to variable-rate debt and to receive interest payments on a current basis.

The SEJ area license royalty is remitted monthly into a yen-denominated account for the benefit of the Company. Principal and interest payments on the 1998 and 2001 Yen Loans are made from this account semiannually in accordance with the loan agreements. After the semiannual principal and interest payments are made from this account, any excess amount, as defined by the loan agreements, is released to the Company for general-purpose use. The account held 329.9 million yen and 351.3 million yen or $2.8 million and $3.3 million at December 31, 2002 and 2003, respectively (see Note 4).

By using its SEJ royalty receipts to service the principal and interest payments on the yen loans, the Company has an economic hedge against fluctuations in the Japanese yen to U.S. dollar exchange rate. Although SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," nullified the hedge accounting treatment the Company was applying to the SEJ royalty and yen loans, the Company's economic hedge against changes in the Japanese yen to U.S. dollar exchange rate remains in place. Upon adoption of SFAS No. 133 on January 1, 2001, the Company adjusted the outstanding yen loans, related interest payable and the SEJ royalty receivable to reflect the Japanese yen to U.S. dollar exchange rate quoted for January 1, 2001 (114.35). As a result, the Company increased the yen loans, related interest payable and SEJ royalty receivable by $16.1 million, with an offsetting charge of $9.8 million (net of deferred taxes of $6.3 million) as a cumulative effect of accounting change in the accompanying consolidated statements of earnings.

The Company adjusts the balance of the yen loans at each reporting date to reflect the current Japanese yen to U.S. dollar exchange rate, and the resultant foreign currency exchange gain or loss is recognized in earnings. In addition, the Company records the SEJ royalty and interest expense on the yen loans at the average Japanese yen to U.S. dollar exchange rate for the respective periods. The Company recorded $15.9 million, $(15.1) million and $(14.0) million of net conversion gain (loss) in OSG&A from the adjustment of the yen loans to the Japanese yen to U.S. dollar exchange rate for the years ended December 31, 2001, 2002 and 2003, respectively.

Cityplace Term Loan – Cityplace Center East Corporation ("CCEC"), a subsidiary of the Company, constructed the headquarters tower, parking garages and related facilities of the Cityplace Center development and is currently obligated to The UFJ Bank, Limited, New York Branch ("UFJ"), which has a lien on the property financed. The debt with UFJ has monthly payments of principal and interest based on a 25-year amortization at 7.5%, with the remaining principal of $199.3 million due on March 1, 2005 (the "Cityplace Term Loan"). Under the terms of the Cityplace Term Loan, the Company is required to maintain cash reserves of $15 million. Upon any sale or refinancing of the building where the proceeds exceed $275 million, CCEC is obligated to pay UFJ an amount equal to the excess less permitted costs.

The Company leases the building from CCEC, occupying part of the building as its corporate headquarters and subleasing the balance to third parties. CCEC pays UFJ an amount that is equal to the Company's rental payments on the property.

Notes Payable to Senior Lenders – As required by FIN 46 (see Notes 1, 12 and19), the Company has consolidated the assets, liabilities, noncontrolling interests and results of activities of certain trusts into its consolidated financial statements effective July 1, 2003. As a result of this consolidation, the accompanying consolidated balance sheets of the Company include $178.1 million in notes payable to senior lenders as of December 31, 2003. Interest on the notes is paid monthly at interest rates of LIBOR plus 2.1% for the note related to the 1999 lease facility and LIBOR plus 1.1% for the note related to the 2001 lease facility. The notes become due when the leases expire, which is February 2005 for the 1999 lease facility and July 2006 for the 2001 lease facility. The notes are collateralized by the assets of the trusts, which principally consist of store properties.

Maturities – Long-term debt maturities assume the continuance of the commercial paper program and the IY guarantee. The maturities, which include capital lease obligations, are as follows (dollars in thousands):

2004	$ 39,828
2005	330,991
2006	183,416
2007	136,236
2008	129,976
Thereafter	654,871
	$1,475,318

Note 10. Convertible Quarterly Income Debt Securities

In November 1995, the Company issued $300 million principal amount of Convertible Quarterly Income Debt Securities due 2010 ("1995 QUIDS") to IY and SEJ. The 1995 QUIDS have no amortization, and interest of 4.5% is payable quarterly. The Company has the right to defer interest payments at any time for up to 20 consecutive quarters. The holder of the 1995 QUIDS can convert the debt anytime at a rate of $20.80 per share of the Company's common stock. The conversion rate represents a premium to the market value of the Company's common stock at the time of issuance of the 1995 QUIDS.

In February 1998, the Company issued $80 million principal amount of Convertible Quarterly Income Debt Securities due 2013 ("1998 QUIDS") to IY and SEJ. The 1998 QUIDS had no amortization, and interest of 4.5% was payable quarterly. Under the terms of the agreement, all of the outstanding 1998 QUIDS were converted into 6,501,685 shares of 7-Eleven, Inc. common stock at the conversion price of $12.3045 per share in September 2003.

The accompanying financial statements include interest payable of $760,000 and $600,000 as of December 31, 2002 and 2003, respectively, as well as interest expense of $17.4 million for the years ended December 31, 2001 and 2002, and $16.3 million for the year ended December 31, 2003, related to the 1995 QUIDS and the 1998 QUIDS. As of December 31, 2003, the Company had not deferred any interest payments in connection with the 1995 QUIDS.

Note 11. Financial Instruments

Fair Value – The disclosure of the estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies as indicated below.

The carrying amounts of cash and cash equivalents, trade accounts receivable, trade accounts payable and accrued expenses and other liabilities are reasonable estimates of their fair values. Letters of credit are included in the estimated fair value of accrued expenses and other liabilities.

Notes to Consolidated Financial Statements

The carrying amounts and estimated fair values of other financial instruments are listed in the following table:

December 31	2002 Carrying Amount	2002 Estimated Fair Value	2003 Carrying Amount	2003 Estimated Fair Value
	(Dollars in thousands)			
Commercial paper	$476,396	$476,396	$318,633	$318,633
Debentures	389,795	356,152	—	—
Senior Subordinated Notes due to SEJ	—	—	400,000	—
Yen Loans	144,411	146,064	144,368	144,423
Cityplace Term Loan	214,205	222,708	207,886	212,666
Notes payable to senior lenders (see Note 9)	—	—	178,069	178,069
Convertible quarterly income debt securities	380,000	—	300,000	—
Interest rate swap	14,560	14,560	3,109	3,109

The methods and assumptions used in estimating the fair value for each of the classes of financial instruments presented in the table above are as follows:

- Commercial paper borrowings are sold at market interest rates and have an average remaining maturity of less than 26 days and 35 days in 2002 and 2003, respectively. Therefore, the carrying amount of commercial paper is a reasonable estimate of its fair value. The guarantee of the commercial paper by IY is an integral part of the estimated fair value of the commercial paper borrowings.
- The fair value of the Debentures is estimated based on December 31, 2002, bid prices obtained from investment banking firms where traders regularly make a market for these financial instruments. The carrying amount of the Debentures includes $20.6 million of SFAS No. 15 Interest.
- It is not practicable, without incurring excessive costs, to estimate the fair value of the Senior Subordinated Notes due to SEJ. As a result of the Company's relationship with SEJ, the Company was able to obtain financing with a weighted-average interest rate of 3.4%.
- The fair value of the Yen Loans is estimated by calculating the present value of the future yen cash flows at current interest and exchange rates.
- The fair value of the Cityplace Term Loan is estimated by calculating the present value of the future cash flows at a current interest rate for a similar financial instrument.
- The carrying amount of the notes payable to senior lenders is a reasonable estimate of its fair value as the associated interest rates are at current market rates.
- It is not practicable, without incurring excessive costs, to estimate the fair value of the convertible quarterly income debt securities (see Note 10). The fair value would be the sum of the fair values assigned to both an interest rate and an equity component of the debt by a valuation firm.
- The fair value of the interest rate swap is estimated based on discounted cash flows for the term of the swap using forward three-month LIBOR rates as of December 31, 2002 and 2003, and represents the estimated amount the Company would pay if the Company chose to terminate the swap as of December 31, 2002 and 2003.

Derivatives – From time to time, the Company uses derivative financial instruments to reduce its exposure to market risk resulting from fluctuations in interest rates. The Company was party to a $250 million notional principal amount interest rate swap agreement that expired in February 2004. During the term of the agreement, the Company paid a fixed interest rate of 6.096% on the $250 million notional amount, and a major financial institution, as counterparty to the agreement, paid the Company interest at a floating rate based on three-month LIBOR on the notional amount. Interest payments were made quarterly on a net settlement basis. The interest rate swap was accounted for as a hedge and, accordingly, any difference between amounts paid and received was recorded as interest expense. The impact on net interest expense as a result of this agreement was an increase of $4.3 million, $10.9 million and $12.3 million for the years ended December 31, 2001, 2002 and 2003, respectively.

Under SFAS No. 133, the $250 million interest rate swap was treated as a cash flow hedge of the Company's interest rate exposure in connection with its commercial paper program. Upon adoption of SFAS No. 133 on January 1, 2001, the Company recorded a liability of $2.0 million representing the fair value of the interest rate swap as of January 1, 2001, with the offset of $1.2 million

(net of deferred taxes of $784,000) to accumulated other comprehensive earnings. The Company adjusted the carrying value of the interest rate swap to fair value at each reporting date with a corresponding offset to accumulated other comprehensive earnings. Additionally, the Company reviewed the effectiveness of the interest rate swap at each reporting date and recognized the ineffective portion of the interest rate swap in earnings for the period reported. The Company recognized charges of $310,000 and $440,000 and a credit of $480,000 to interest expense in connection with ineffectiveness for the years ended December 31, 2001, 2002 and 2003, respectively.

In addition, upon adoption of SFAS No. 133, the Company transferred January 1, 2001, asset and liability balances of $2.4 million and ($4.3 million), respectively, related to previous interest rate swap activity, to accumulated other comprehensive earnings. These balances were amortized into earnings as an adjustment to interest expense through February 2004.

Note 12. Leases

Leases – Certain property and equipment used in the Company's business is leased. Generally, real estate leases are for primary terms from 14 to 20 years with options to renew for additional periods, and equipment leases are for terms from one to 10 years.

In 1999 and 2001, the Company entered into lease facilities that provided $96.6 million and $97.7 million, respectively, in off-balance sheet financing, which was used for constructing new stores and acquiring operating convenience stores from third parties not affiliated with the Company. Under the agreements, trusts funded by a group of senior lenders either acquired land and undertook construction projects with the Company acting as the construction agent or acquired operating convenience stores. After a store was constructed or acquired, the trusts leased the store to the Company for an amount equal to the interest expense on the applicable store's construction costs or, in the case of operating convenience stores, the acquisition price of the land, building, motor fuels equipment and other fixtures, at LIBOR plus 2.1% for the 1999 facility and LIBOR plus 1.1% for the 2001 facility. The base lease terms under these facilities expire in February 2005 and July 2006, respectively. In 2002, the Company purchased two of the stores for a total of $3.3 million, and in February 2004, the Company purchased two additional stores for a total of $2.7 million.

Under both agreements, after the initial lease term has expired, the Company has the option of (a) extending the lease for an additional period subject to the approval of the trust; (b) purchasing the property for an amount approximating the trust's interest in such property, which is equal to the total amount of funds advanced by the trust; or (c) vacating the property, arranging for the sale to a third party and paying the trust the net proceeds from the sale. If the sale proceeds are less than the trust's interest in the property, the Company is required to reimburse the trust for the deficiency (such reimbursement not to exceed 84% of the trust's interest in the property). If the sale proceeds exceed the trust's interest in the properties, the Company is entitled to all of such excess amounts. The leases contain financial and operating covenants similar to those under the Company's Credit Agreement (see Note 9).

Effective July 1, 2003, the Company includes the assets, liabilities, noncontrolling interests and results of activities of these trusts in its consolidated financial statements as required by FIN 46 (see Notes 1, 9 and 19). Consolidation of these trusts into the Company's financial statements resulted in an after-tax, one-time cumulative effect charge of $10.2 million (net of deferred tax benefit of $6.6 million). As of July 1, 2003, the Company also recorded $178.1 million in notes payable to senior lenders, $157.4 million (net of accumulated depreciation of $16.3 million) in property and equipment and $10.5 million of other net assets as a result of consolidating the trusts into its financial statements. The Company paid $6.4 million and $2.8 million in rent expense to the trusts in 2002 and 2003, respectively, before the trusts were consolidated into the Company's financial statements effective July 1, 2003. After the trusts were consolidated, such rent expense is classified as interest expense in the Company's financial statements. Accordingly, the Company paid $2.7 million in interest expense to the trusts' senior lenders under the terms of the agreements in 2003.

Effective November 2002, the Company entered into a lease facility with a third-party institution that provided the Company with $43.2 million in financing for Vcom equipment. The leases are being accounted for as capital leases having a five-year lease term from the date of funding, which occurred on a monthly basis from December 2002 through June 2003. The leases bear interest at LIBOR plus 1.25%. Upon lease termination, whether prior to or at expiration of the five-year lease term, the Company is obligated to pay the lessor an amount equal to the original cost of the equipment financed less amortization to date plus accrued interest. The Company has recorded $8.6 million and $39.1 million in capital lease liabilities as of December 31, 2002 and 2003, respectively.

The composition of capital leases reflected as property and equipment in the consolidated balance sheets is as follows:

December 31	2002	2003
	(Dollars in thousands)	
Buildings	$ 208,546	$ 219,186
Equipment	10,196	44,513
Software	40,813	41,036
	259,555	304,735
Accumulated amortization	(91,451)	(110,939)
	$ 168,104	$ 193,796

The present value of future minimum lease payments for capital lease obligations is reflected in the consolidated balance sheets as long-term debt. The amount representing imputed interest necessary to reduce net minimum lease payments to present value has been calculated generally at the Company's incremental borrowing rate at the inception of each lease.

Future minimum lease payments for years ending December 31 are as follows:

	Capital Leases	Operating Leases
	(Dollars in thousands)	
2004	$ 36,476	$ 194,842
2005	38,702	167,123
2006	36,638	145,002
2007	32,894	119,375
2008	26,311	94,960
Thereafter	194,761	658,736
Future minimum lease payments	365,782	$1,380,038
Estimated executory costs	(66)	
Amount representing imputed interest	(141,179)	
Present value of future minimum lease payments	$224,537	

Minimum noncancelable sublease rental income to be received in the future, which is not included above as an offset to future payments, totals $6.7 million for capital leases and $5.9 million for operating leases as of December 31, 2003.

Rent expense on operating leases for the years ended December 31, 2001, 2002 and 2003, totaled $211.2 million, $223.4 million and $236.6 million, respectively, including contingent rent expense of $13.2 million, $12.9 million and $13.0 million, which has been reduced by sublease rent income of $3.6 million in each of the three years. Contingent rent expense on capital leases was $1.5 million in each of the years ended December 31, 2001, 2002 and 2003. Contingent rent expense is generally based on sales levels or changes in the Consumer Price Index.

Leases with the Savings and Profit Sharing Plan – At December 31, 2003, the 7-Eleven, Inc. Employees' Savings and Profit Sharing Plan ("Savings and Profit Sharing Plan") owned one store that was leased to the Company under a capital lease and 408 stores that were leased to the Company under operating leases at rentals which, in the opinion of management, approximated market rates at the inception date of each lease. In addition, in 2001, 2002 and 2003, there were 71, 44 and 12 leases, respectively, that either expired or, as a result of properties that were sold by the Savings and Profit Sharing Plan to third parties, were canceled or assigned to the new owner. Also, the Company exercised its right of first refusal and purchased two, 10 and one properties from the Savings and Profit Sharing Plan in 2001, 2002 and 2003, respectively, for an aggregate purchase price of $748,000, $3.4 million and $340,000 in the respective years.

Rent expense under operating leases and amortization of capital lease assets were $17.6 million, $16.2 million and $15.3 million for the years ended December 31, 2001, 2002 and 2003, respectively, for leases with the Savings and Profit Sharing Plan.

Note 13. Benefit Plans

Profit Sharing Plans – The Company maintains the Savings and Profit Sharing Plan for its U.S. employees and the 7-Eleven Canada, Inc. Pension Plan for its Canadian employees. These plans provide retirement benefits to eligible employees.

Contributions to the Savings and Profit Sharing Plan, a 401(k) defined contribution plan, are made by both the participants and 7-Eleven. The Savings and Profit Sharing Plan was amended prospectively on February 1, 2002, such that 7-Eleven contributes an amount determined at the discretion of the Company. The contribution by the Company is generally allocated to the participants on the basis of their individual contribution and years of participation in the Savings and Profit Sharing Plan. The provisions of the 7-Eleven Canada, Inc. Pension Plan are similar to those of the Savings and Profit Sharing Plan. Total contributions to these plans for the years ended December 31, 2001, 2002 and 2003, were $15.0 million, $13.5 million and $15.1 million, respectively, and are included in OSG&A.

Postretirement Benefits – The Company's group insurance plan (the "Insurance Plan") provides postretirement medical and dental benefits for all retirees that meet certain criteria. Such criteria include continuous participation in the Insurance Plan ranging from 10 to 15 years depending on hire date, and the sum of age plus years of continuous service equal to at least 70. The Insurance Plan was amended in 2002 to provide for certain changes to eligibility requirements effective January 1, 2003. The Company contributes toward the cost of the Insurance Plan a fixed dollar amount per retiree based on age and number of dependents covered, as adjusted for actual claims experience. All other future costs and cost increases will be paid by the retirees. The Company continues to fund its cost on a cash basis; therefore, no plan assets have been accumulated.

Pursuant to the Company's policy, if cumulative unrecognized gains or losses at the beginning of a period exceed 40% of the accumulated postretirement benefit obligation, the entire unrecognized gain or loss is amortized over a three-year period beginning in the subsequent year. The Company believes this method of amortization results in a more accurate reflection of its postretirement benefit obligation by providing for more immediate recognition of gains and losses. Because the 40% threshold was first exceeded at the beginning of 2000, the accelerated amortization method was first applied in 2001. If cumulative unrecognized gains or losses at the beginning of a period are between 10% and 40% of the accumulated postretirement benefit obligation, the unrecognized gain or loss is amortized over the expected years of future service. If the percentage is less than 10%, there is no amortization.

The following information on the Company's Insurance Plan is provided:

December 31	2002	2003
	(Dollars in thousands)	
Change in Benefit Obligation		
Net benefit obligation at beginning of year	$ 22,346	$22,565
Service cost	694	884
Interest cost	1,566	1,539
Plan participants' contributions	3,692	4,169
Plan amendments	2,912	—
Actuarial gain	(3,715)	(1,928)
Gross benefits paid	(4,930)	(6,292)
Net benefit obligation at end of year	$ 22,565	$ 20,937
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ —	$ —
Employer contributions	1,238	2,123
Plan participants' contributions	3,692	4,169
Gross benefits paid	(4,930)	(6,292)
Fair value of plan assets at end of year	$ —	$ —
Funded status at end of year	$(22,565)	$(20,937)
Unrecognized net actuarial gain	(4,938)	(4,037)
Unrecognized prior service cost	2,912	2,525
Accrued benefit costs	$(24,591)	$(22,449)

Notes to Consolidated Financial Statements

Years Ended December 31	2001	2002	2003
		(Dollars in thousands)	
Components of Net Periodic Benefit Cost			
Service cost	$ 573	$ 694	$ 884
Interest cost	1,557	1,566	1,539
Prior service cost	—	—	387
Amortization of actuarial gain	(2,964)	(2,829)	(2,829)
Net periodic benefit cost	$ (834)	$ (569)	$ (19)
End-of-Year Assumptions Used			
Discount rate	7.00%	6.75%	6.25%
Health care cost trend on covered charges			
2002 trend	10.00%	N/A	N/A
2003 trend	9.00%	13.00%	N/A
2004 trend	8.00%	12.00%	12.00%
Ultimate trend	6.00%	6.00%	6.00%
Ultimate trend reached in	2006	2010	2010

	Gross Payments	Employer Payments
	(Dollars in thousands)	
Estimated Future Benefit Payments		
2004	$ 7,681	$ 1,197
2005	9,399	1,306
2006	11,124	1,407
2007	12,926	1,495
2008	14,674	1,557
Years 2009 - 2013	104,636	9,069

There is no effect of a one-percentage-point increase or decrease in assumed health care cost trend rates on either the total service and interest cost components or the postretirement benefit obligation for the years ended December 31, 2001, 2002 and 2003, as the Company contributes a fixed dollar amount.

Executive Protection Plan – The Company maintains the Executive Protection Plan (“EPP”), which is a supplementary benefit plan, for certain key employees of the Company. In addition to the disability and life insurance coverage available to all full-time employees of the Company, the EPP participants are eligible for supplemental disability benefits and life insurance coverage before they retire. After they retire, they are eligible for the postretirement income benefits of the EPP. No EPP assets have been accumulated as the Company funds its costs on a cash basis.

Notes to Consolidated Financial Statements

The following information on the Company's EPP is provided:

December 31	2002	2003
	(Dollars in thousands)	
Change in Benefit Obligation		
Net benefit obligation at beginning of year	$ 14,131	$ 18,275
Service cost	513	798
Interest cost	993	1,253
Actuarial loss	3,496	1,021
Gross benefits paid	(858)	(953)
Net benefit obligation at end of year	$ 18,275	$ 20,394
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ —	$ —
Employer contributions	858	953
Gross benefits paid	(858)	(953)
Fair value of plan assets at end of year	$ —	$ —
Funded status at end of year	$(18,275)	$(20,394)
Unrecognized net actuarial loss	2,464	3,426
Unrecognized prior service cost	4,003	3,537
Net amount recognized at end of year	$(11,808)	$(13,431)
Amounts recognized in statement of financial position consist of:		
Accrued benefit liability	$(11,808)	$(13,431)
Additional minimum liability	(3,755)	(3,937)
Intangible asset	3,755	3,537
Accumulated other comprehensive earnings	—	400
Net amount recognized	$(11,808)	$(13,431)
Accumulated Benefit Obligation (ABO)	$(15,563)	$(17,368)

Years Ended December 31	2001	2002	2003
		(Dollars in thousands)	
Components of Net Periodic Benefit Cost			
Service cost	$ 454	$ 513	$ 798
Interest cost	935	993	1,253
Amortization of prior service cost	465	465	465
Amortization of actuarial (gain) loss	(92)	—	58
Net periodic benefit cost	$1,762	$1,971	$2,574
End-of-Year Assumptions Used			
Discount rate	7.50%	7.00%	6.75%
Rate of compensation increase	6.00%	6.00%	5.00%

Note 14. Commitments and Contingencies

Distribution Services – In July 2002, the Company signed a 40-month service agreement with McLane Company, Inc. ("McLane") under which McLane provides its distribution services to 7-Eleven stores and designated combined distribution centers in the United States. The agreement became effective in September 2002 and replaced an agreement that expired in November 2002. Under the terms of the agreement, the Company's corporate stores are required to purchase a minimum percentage of eligible purchases from McLane. The Company has met the required minimum percentages each year and expects to meet the required minimum percentages in 2004.

Notes to Consolidated Financial Statements

Gasoline Supply – The Company has a 20-year product purchase agreement with Citgo Petroleum Corporation ("Citgo") to buy specified quantities of gasoline at market prices. The agreement expires September 2006. The market prices are determined pursuant to a formula based on the prices posted by gasoline wholesalers in the various market areas where the Company purchases gasoline from Citgo. Minimum required annual purchases under this agreement are generally the lesser of 750 million gallons or 35% of gasoline purchased by the Company for retail sale. The Company has met the minimum required annual purchases each year and expects to meet the minimum required annual purchase levels in 2004.

Information Technology – In January 2002, the Company entered into a seven-year contract with an information technology service provider. The Company is required to purchase a minimum of $25 million of services annually. In addition, the Company has other information technology service provider contracts whereby it is required to purchase a minimum of approximately $40 million of services in 2004, and $35 million in 2005. The Company has historically exceeded these thresholds for information technology expenditures and expects to fully utilize the required minimum level of services in the future.

Product Commitments – The Company has various contracts for product purchases that require it to purchase a minimum amount of products annually. The Company has generally exceeded such minimum requirements in the past and expects to continue doing so for the foreseeable future. Failure to satisfy the minimum purchase requirements could result in termination of the contracts, changes in pricing of the products and payments to the applicable provider(s) of a predetermined percentage of the commitment(s).

Environmental – The Company accrues for the anticipated future costs and the related probable state reimbursement amounts for remediation activities at its existing and previously operated gasoline storage sites where releases of regulated substances have been detected. At December 31, 2002 and 2003, the Company's estimated undiscounted liability for these sites was $36.5 million and $38.5 million, respectively, of which $17.7 million and $19.7 million are included in deferred credits and other liabilities and the remainder is included in accrued expenses and other liabilities (see Notes 7 and 8). The Company anticipates that substantially all of the future remediation costs for detected releases at these sites as of December 31, 2003, will be incurred within the next five or six years.

Under state reimbursement programs, the Company is eligible to receive reimbursement for a portion of future remediation costs, as well as a portion of remediation costs previously paid. Accordingly, at December 31, 2002 and 2003, the Company has recorded net receivable amounts of $60.0 million and $51.7 million, respectively, for the estimated probable state reimbursements, of which $34.1 million and $28.0 million relate to remediation costs incurred in the state of California. Of the total receivables, $53.5 million and $46.2 million are included in other assets, and the remainder is included in accounts receivable (see Note 2). In assessing the probability of state reimbursements, the Company takes into consideration each state's fund balance, revenue sources, existing claim backlog, status of cleanup activity and claim ranking. As a result of these assessments, the recorded receivable amounts in other assets are net of allowances of $10.8 million and $11.4 million as of December 31, 2002 and 2003, respectively.

While there is no assurance of the timing of the receipt of state reimbursement funds, based on the Company's experience, the Company expects to receive the majority of state reimbursement funds, except from California, within one to three years after payment of eligible remediation expenses, assuming that the state administrative procedures for processing such reimbursements follow historic payment practices. The Company estimates that it will receive reimbursement of most of its identified remediation expenses in California, although it may take additional years to receive those reimbursement funds. The California reimbursement program separates claims into four classes: A, B, C and D. The Company's claims are in Class D. As a result of the growing backlog of Class D claims and its impact on the Company's estimate of when it will receive funds from the California reimbursement program, the Company recorded a $7.0 million charge to OSG&A in 2003 to reflect its best estimate of the fair value of its California remediation receivable.

As a result of the expected timing for the receipt of reimbursement funds from California, the portion of the recorded California receivable amounts related to remedial activities that have already been completed has been discounted at approximately 3.9% and 5.0% as of December 31, 2002 and 2003, respectively, to reflect present values. Thus, the December 31, 2002 and 2003 recorded receivable amounts are also net of present value discounts of $8.4 million and $19.2 million, respectively.

The Company has recognized remediation expenses of $20.1 million, $23.7 million and $27.6 million (which includes the $7.0 million charge noted above related to the California receivable), offset by recoveries of $9.4 million, $11.5 million and $4.9 million, for the years ended December 31, 2001, 2002 and 2003, respectively. Such expenses are reflected in OSG&A expense in the accompanying consolidated statements of earnings. The estimated future remediation expenditures and related state reimbursement

amounts could change within the near future as governmental requirements and state reimbursement programs continue to be revised. Such revisions could have a material impact on the Company's operations and financial position.

Litigation and Tax Assessments – The Company is a party to various claims and matters of litigation and tax assessments incidental to the normal course of its business. Management believes that the final resolution of these matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Other – Effective January 1, 2003, the Company has guaranteed $3.7 million of a five-year, $15 million note between the Company's equity affiliate in Mexico and a third-party lending institution. The affiliate obtained the loan for the purpose of restructuring existing debt. The guaranteed amount is the maximum potential amount that the Company could be required to pay in the event of default by its affiliate.

The Company has contracts with its combined distribution center operators that require it to process a certain level of products through the facilities. The failure to satisfy the minimum purchases causes the Company to pay the applicable operator a predetermined fee. The Company estimates that it will pay approximately $8.0 million in such fees over the next three years. For the years ended December 31, 2001, 2002 and 2003, the Company paid $554,000, $897,000 and $3.8 million, respectively. Such amounts are reflected in merchandise cost of goods sold.

The Company's franchise agreement includes a guarantee to its franchisees of a minimum amount of annual gross income, which is the franchisee's share of the gross profit split (see Note 1). By policy, and not as part of the franchise agreement, the Company also offers an additional gross income guarantee to its franchisees if certain conditions are met. Under these programs, the Company reduces its share of the gross profit split such that the franchisee will receive the guaranteed amount, generally $60,000 per year. The Company reduced its share of the gross profit split from franchisees under the combined programs by $1.0 million, $932,000 and $762,000 for the years ended December 31, 2001, 2002 and 2003, respectively.

Note 15. Preferred Stock and Stock Plans

Preferred Stock – The Company has 5 million shares of preferred stock authorized for issuance. Any preferred stock issued will have such rights, powers and preferences as determined by the Company's Board of Directors.

Stock Incentive Plan – A summary of the status of the Stock Incentive Plan (see Note 1) as of December 31, 2001, 2002 and 2003, and changes during the years then ended, is presented below:

	2001		2002		2003	
Fixed Options	**Shares (000's)**	**Weighted-Average Exercise Price**	**Shares (000's)**	**Weighted-Average Exercise Price**	**Shares (000's)**	**Weighted-Average Exercise Price**
Outstanding at beginning of year	4,891	$14.95	5,524	$14.32	6,568	$13.22
Granted	875	10.92	1,449	9.16	1,498	6.88
Exercised	(24)	9.44	(5)	9.46	(301)	10.14
Forfeited	(218)	15.38	(400)	13.78	(473)	10.88
Outstanding at end of year	5,524	14.32	6,568	13.22	7,292	12.19
Options exercisable at year-end	2,662	14.03	3,300	14.07	3,763	14.11
Weighted-average fair value of options granted during the year	$ 6.58		$ 5.50		$ 3.87	

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Options Outstanding at 12/31/03 (000's)**	**Weighted-Average Remaining Contractual Life**	**Weighted-Average Exercise Price**	**Options Exercisable at 12/31/03 (000's)**	**Weighted-Average Exercise Price**
$ 6.88 – $10.42	3,547	7.89	$ 8.34	1,048	$ 9.39
10.92 – 12.35	1,123	6.07	11.46	689	11.79
15.00 – 15.94	946	2.30	15.45	947	15.45
19.00 – 19.06	1,676	5.94	19.00	1,079	19.00
6.88 – 19.06	7,292			3,763	

The Stock Incentive Plan provides for the granting of other forms of stock-based awards to certain key employees and officers of the Company. The Company granted 140,000 shares and 10,000 shares of restricted stock under the Stock Incentive Plan in 2002 and 2003, respectively. Upon issuance of the restricted stock, $1.3 million and $115,000 in unearned compensation equivalent to the market value at the date of grant was charged to shareholders' equity in the accompanying consolidated balance sheets as of December 31, 2002 and 2003, respectively. The amounts are being amortized to expense over a four-year vesting period.

Stock Purchase Plans – In 1999, the Company adopted noncompensatory stock purchase plans that allow qualified employees and franchisees to acquire shares of the Company's common stock at market value on the open market. The Company is responsible for the payment of all administrative fees for establishing and maintaining the stock purchase plans as well as the payment of all brokerage commissions for the purchase of shares by the plans' independent administrator. In 2001, the Company added a matching-contribution component to the employee plan equal to 10% of the individual's common stock purchases for the year with certain restrictions applying. The Company's matching contribution was $73,000 and $64,000 for the years ended December 31, 2002 and 2003, respectively.

Stock Compensation Plan for Non-Employee Directors – In 1998, the Company established the Non-Employee Directors Plan (see Note 1) under which up to an aggregate of 240,000 shares of the Company's common stock is authorized to be issued to its non-employee directors. Eligible directors may elect to receive all, none or a portion of their directors' fees in shares of the Company's common stock. During 2001, 2002 and 2003, respectively, 16,606, 22,637 and 34,005 shares were issued under the Non-Employee Directors Plan. Of the total shares issued under this plan in 2002 and 2003, 4,960 shares and 26,634 shares, respectively, were restricted such that vesting will not occur until the first of the month following the date of the director's retirement from the board. Also under the Non-Employee Directors Plan, 24,000 stock options were issued in May 2003 at an exercise price of $9.30, which is the fair market value of the Company's common stock on the date of grant.

Note 16. Income Taxes

The components of earnings from continuing operations before income tax expense and cumulative effect of accounting change are as follows:

Years Ended December 31	2001	2002	2003
		(Dollars in thousands)	
Domestic (including royalties of $80,816, $67,246 and $47,308 from area license agreements in foreign countries)	$159,306	$ 93,420	$134,872
Foreign	7,882	9,008	6,108
	$167,188	$102,428	$140,980

The provision for income tax expense on earnings from continuing operations before cumulative effect of accounting change in the accompanying consolidated statements of earnings consists of the following:

Years Ended December 31	2001	2002	2003
		(Dollars in thousands)	
Current			
Federal	$21,085	$ 6,749	$18,248
Foreign	11,148	10,977	6,686
State	4,829	3,000	3,300
Subtotal	37,062	20,726	28,234
Deferred	28,141	20,245	25,338
Income tax expense on earnings from continuing operations before cumulative effect of accounting change	$65,203	$40,971	$53,572

Notes to Consolidated Financial Statements

Reconciliations of income tax expense on earnings from continuing operations before cumulative effect of accounting change at the federal statutory rate to the Company's actual income tax expense provided are as follows:

Years Ended December 31	2001	2002	2003
		(Dollars in thousands)	
Tax expense at federal statutory rate	$ 58,516	$35,850	$49,343
Federal income tax settlement	(1,522)	—	—
State income tax expense, net of federal income tax benefit	3,139	2,768	5,040
Foreign tax rate difference	2,117	(1,254)	(1,132)
Other	2,953	3,607	321
	$65,203	$ 40,971	$53,572

Significant components of the Company's deferred tax assets and liabilities are as follows:

December 31	2002	2003
	(Dollars in thousands)	
Deferred tax assets		
Accrued liabilities	$ 54,715	$ 63,291
Compensation and benefits	30,445	30,902
Accrued insurance	27,004	26,254
Debt issuance costs	12,268	10,414
Tax credit and NOL carryforwards	19,260	4,500
SFAS No. 15 Interest	8,283	—
Other	6,704	6,562
Subtotal	158,679	141,923
Deferred tax liabilities		
Property and equipment	(178,359)	(191,682)
Area license agreements	(42,102)	(41,050)
Other	(6,536)	(5,708)
Subtotal	(226,997)	(238,440)
Net deferred tax liability	$ (68,318)	$ (96,517)

At December 31, 2003, the Company had approximately $4.5 million of alternative minimum tax credit carryforwards with no expiration date.

Notes to Consolidated Financial Statements

Note 17. Earnings Per Common Share

Computations for basic and diluted earnings per common share are presented below:

Years Ended December 31	2001	2002	2003
	(In thousands, except per-share data)		
Basic			
Earnings from continuing operations before cumulative effect of accounting change	$ 101,985	$ 61,457	$ 87,408
Loss on discontinued operations	(8,418)	(20,541)	(13,070)
Cumulative effect of accounting change	(9,847)	(28,139)	(10,244)
Net earnings	$ 83,720	$ 12,777	$ 64,094
Weighted-average common shares outstanding	104,800	104,827	106,815
Earnings per common share from continuing operations before cumulative effect of accounting change	$ .97	$ .59	$ .82
Loss per common share on discontinued operations	(.08)	(.20)	(.12)
Loss per common share on cumulative effect of accounting change	(.09)	(.27)	(.10)
Net earnings per common share	$ .80	$ .12	$ .60
Diluted			
Earnings from continuing operations before cumulative effect of accounting change	$ 101,985	$ 61,457	$ 87,408
Add interest on convertible quarterly income debt securities, net of tax – see Note 10	10,627	2,191	10,111
Earnings from continuing operations before cumulative effect of accounting change plus assumed conversions	112,612	63,648	97,519
Loss on discontinued operations	(8,418)	(20,541)	(13,070)
Cumulative effect of accounting change	(9,847)	(28,139)	(10,244)
Net earnings plus assumed conversions	$ 94,347	$ 14,968	$ 74,205
Weighted-average common shares outstanding (Basic) (2)	104,800	104,827	106,815
Add effects of assumed conversions			
Stock options and restricted stock – see Note 15 (1)	187	140	1,380
Convertible quarterly income debt securities – see Note 10 (2)	20,924	6,503	19,054
Weighted-average common shares outstanding plus shares from assumed conversions (Diluted)	125,911	111,470	127,249
Earnings per common share from continuing operations before cumulative effect of accounting change	$ .90	$ .56	$ .76
Loss per common share on discontinued operations	(.07)	(.18)	(.10)
Loss per common share on cumulative effect of accounting change	(.08)	(.25)	(.08)
Net earnings per common share	$ .75	$ .13	$ .58

(1) Stock options for 3,412, 6,568 and 3,043 shares of common stock for the years ended December 31, 2001, 2002 and 2003, respectively, have exercise prices that are greater than the average market prices of the common shares for each respective year. Therefore, these shares have not been included in diluted earnings-per-share calculations.

(2) The 1995 QUIDS are not assumed converted for the year ended December 31, 2002, as they have an antidilutive effect on earnings per common share. The 1998 QUIDS were converted in 2003 (see Note 10).

Note 18. Other Related Party Transactions

Related Party Loan – In May 2002, a financial-services subsidiary of SEJ made a personal loan of 227.5 million Japanese yen (approximately $1.75 million) to one of the Company's non-employee directors. The term of the loan, which is secured by certain shares of stock owned by the director and bears interest at 2.6%, was extended from May 2003 to May 2004.

Note 19. Recently Issued Accounting Standards

In April 2003, the FASB issued SFAS No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, for hedging relationships designated after June 30, 2003, and to certain preexisting contracts. The Company has adopted the provisions of SFAS No. 149; adopting the statement did not have a material impact on the Company's consolidated financial statements.

Notes to Consolidated Financial Statements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. The provisions of SFAS No. 150 are effective for all financial instruments created or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003. The Company adopted the provisions of SFAS No. 150 as of July 1, 2003; adopting the statement did not have a material impact on the Company's consolidated financial statements.

The FASB issued a revision to SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," in December 2003. The statement revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, "Employers' Accounting for Pensions," SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The revised SFAS No. 132 retains the disclosure requirements contained in the original SFAS No. 132, which it replaces, but it requires additional disclosures about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans as well as interim disclosures. With some exceptions, the revised SFAS No. 132 is effective for financial statements with fiscal years ending after December 15, 2003, and for interim periods beginning after December 15, 2003. The Company adopted the provisions of this statement as of December 31, 2003, and revised the disclosures for its postretirement benefit plans accordingly (see Note 13).

FIN 46 was issued in January 2003 (see Notes 1, 9 and 12). FIN 46 addresses consolidation of VIEs to which the usual condition for consolidation described in Accounting Research Bulletin No. 51, "Consolidated Financial Statements," does not apply because the VIEs have no voting interests or otherwise are not subject to control through ownership of voting interests. It requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The primary beneficiary of a VIE is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. The Company adopted FIN 46 for the trusts discussed in Note 12 as of July 1, 2003. The trusts, which are special purpose entities, were consolidated into the Company's financial statements as of that date in accordance with the provisions of FIN 46 that were in effect at that time.

In December 2003, the FASB issued a revised version of FIN 46 ("FIN 46-R") that establishes the effective dates for public entities to apply FIN 46 and FIN 46-R based on the nature of the VIE and the date on which the public company became involved with the VIE. In general, a public entity that is not a small business issuer shall apply FIN 46-R to all VIEs no later than the end of the first reporting period ending after March 15, 2004. The Company is currently analyzing its franchisee relationships (see Note 1) in accordance with FIN 46 and FIN 46-R to determine if any or all are VIEs. The Company believes that, if consolidation were to occur, it would not have a material impact on the Company's net earnings.

On January 12, 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" in response to a new law regarding prescription drug benefits under Medicare ("Medicare Part D") as well as a federal subsidy to sponsors of retiree health care benefits plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Currently, SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires that changes in relevant law be considered in current measurement of postretirement benefit costs. However, certain accounting issues related to the federal subsidy remain unclear and significant uncertainties may exist that impair a plan sponsor's ability to evaluate the direct effects of the new law and the effects on plan participants' behavior and healthcare costs. Due to these uncertainties, FSP No. 106-1 provides plan sponsors with an opportunity to elect to defer recognizing the effects of the new law in accounting for its retiree health care benefit plans under SFAS No. 106 and to provide related disclosures until authoritative guidance from the FASB on the accounting for the federal subsidy is issued and clarification of other uncertainties is resolved. The Company has elected to defer recognition while evaluating the new law and the pending issuance of authoritative guidance and their effect, if any, on the Company's financial position, results of operations and financial statement disclosure. Therefore, any measures of the accumulated postretirement benefit obligation or the net periodic postretirement benefit cost do not reflect the effects of the new law, and pending authoritative guidance could require the Company to change previously reported information.

Notes to Consolidated Financial Statements

Note 20. Quarterly Financial Data (Unaudited)

The summarized quarterly financial data for 2002 and 2003 below has been restated for both the application of SFAS No. 144 and the revised accounting for sales of prepaid phone cards (see Note 1).

Year Ended December 31, 2002	First Quarter (Restated)	Second Quarter (Restated)	Third Quarter (Restated)	Fourth Quarter (Restated)	Year (Restated)
	(Dollars in millions, except per-share data)				
Merchandise sales	$1,549	$1,810	$1,928	$1,733	$7,020
Gasoline sales	553	715	750	743	2,761
Net sales	2,102	2,525	2,678	2,476	9,781
Merchandise gross profit	548	650	693	605	2,496
Gasoline gross profit	42	75	66	71	254
Gross profit	590	725	759	676	2,750
Income tax expense (benefit)	—	22	20	(1)	41
Earnings (loss) from continuing operations before cumulative effect of accounting change	(1)	34	30	(1)	62
Loss on discontinued operations	(10)	(1)	—	(10)	(21)
Cumulative effect of accounting change	(28)	—	—	—	(28)
Net earnings (loss)	(39)	33	30	(11)	13
Net earnings (loss) per common share from continuing operations before cumulative effect of accounting change					
Basic	(.01)	.32	.28	(.01)	.59
Diluted	(.01)	.29	.26	(.01)	.56
Net earnings (loss) per common share					
Basic	(.37)	.32	.28	(.11)	.12
Diluted	(.37)	.29	.25	(.11)	.13

In 2003, the Company revised its accounting for sales of prepaid phone cards to report revenues net of related costs in conformity with the provisions of EITF Issue No. 99-19 (see Note 1). As a result of this change, merchandise cost of goods sold amounts of $35.8 million, $36.5 million, $39.8 million and $43.4 million for the consecutive quarters in the year ended December 31, 2002, have been recorded as a reduction of merchandise sales. Net sales has also been adjusted by these amounts. The change has no effect on previously reported merchandise gross profit dollars, earnings from continuing operations or net earnings.

The first quarter's earnings from continuing operations includes employee severance expense of $2.9 million (net of tax benefit of $2.0 million). The first quarter also includes a cumulative effect of accounting change expense of $28.1 million (net of deferred tax benefit of $18.8 million) from the adoption of SFAS No. 143 (see Note 1). The second quarter's earnings from continuing operations includes a net conversion loss of $8.4 million (net of deferred tax benefit of $5.6 million) primarily resulting from adjusting the balance of the yen loans to reflect the end-of-period exchange rate of yen to U.S. dollar (see Note 9). The first and fourth quarters' loss on discontinued operations includes a charge of $6.9 million (net of deferred tax benefit of $4.7 million) and $8.3 million (net of deferred tax benefit of $5.5 million), respectively, related to store closings (see Note 5).

Notes to Consolidated Financial Statements

Year Ended December 31, 2003	First Quarter (Restated)	Second Quarter (Restated)	Third Quarter (Restated)	Fourth Quarter	Year
	(Dollars in millions, except per-share data)				
Merchandise sales	$1,649	$ 1,881	$2,026	$ 1,857	$ 7,413
Gasoline sales	816	826	898	832	3,372
Net sales	2,465	2,707	2,924	2,689	10,785
Merchandise gross profit	576	676	723	660	2,635
Gasoline gross profit	68	92	90	76	326
Gross profit	644	768	813	736	2,961
Income tax expense	4	25	22	3	54
Earnings from continuing operations before cumulative effect of accounting change	7	40	35	5	87
Loss on discontinued operations	(2)	(1)	1	(11)	(13)
Cumulative effect of accounting change	—	—	(10)	—	(10)
Net earnings (loss)	5	39	26	(6)	64
Net earnings per common share from continuing operations before cumulative effect of accounting change					
Basic	.07	.38	.33	.05	.82
Diluted	.07	.34	.29	.04	.76
Net earnings (loss) per common share					
Basic	.05	.37	.24	(.05)	.60
Diluted	.05	.33	.22	(.05)	.58

In 2003, the Company revised its accounting for sales of prepaid phone cards to report revenues net of related costs in conformity with the provisions of EITF Issue No. 99-19 (see Note 1). As a result of this change, merchandise cost of goods sold amounts of $49.2 million, $61.9 million and $64.7 million for the first three consecutive quarters in the year ended December 31, 2003, have been recorded as a reduction of merchandise sales. Net sales has also been adjusted by these amounts. The change has no effect on previously reported merchandise gross profit dollars, earnings from continuing operations or net earnings.

The first quarter's earnings from continuing operations includes the receipt of life insurance proceeds of $2.2 million (net of deferred taxes of $1.4 million). The third quarter includes a cumulative effect of accounting change expense of $10.2 million (net of deferred tax benefit of $6.6 million) from the adoption of FIN 46 (see Notes 1, 9, 12 and 19). In addition, the third quarter's earnings from continuing operations includes (a) a gain of $6.5 million (net of deferred taxes of $4.0 million) from the retirement of the Company's Debentures (see Note 9), (b) an expense of $6.2 million (net of deferred tax benefit of $3.7) from foreign currency conversion and (c) $4.3 million (net of deferred tax benefit of $2.7 million) to reflect the Company's best estimate of the fair value of its California remediation receivable (see Note 14). The fourth quarter's loss on discontinued operations includes a charge of $8.9 million (net of deferred tax benefit of $5.5 million) related to store closing (see Note 5).

Report of Independent Auditors

To the Board of Directors and Shareholders of 7-Eleven, Inc.:

We have audited the accompanying consolidated balance sheets of 7-Eleven, Inc. and Subsidiaries as of December 31, 2002 and 2003, and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of 7-Eleven, Inc. and Subsidiaries as of December 31, 2002 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1, 5, 6, 8, 9, 11 and 12 to the consolidated financial statements, the Company adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," in 2001, the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," SFAS No. 143, "Accounting for Asset Retirement Obligations," and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," in 2002, and the provisions of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" and FASB Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51," in 2003.

Additionally, as discussed in Note 1 to the consolidated financial statements, the Company has revised the accounting for pre-paid phone card sales in its December 31, 2001 and 2002 consolidated financial statements.

PricewaterhouseCoopers LLP

PriceWaterhouseCoopers LLP

Dallas, Texas
January 29, 2004

Directors and Officers

Directors

Toshifumi Suzuki
Chairman of the Board

Yoshitami Arai
Director

Masaaki Asakura
Director

Timothy Ashida
Director

Jay W. Chai
Director

Gary J. Fernandes
Director

Masaaki Kamata
Director

James W. Keyes
Director

Kazuo Otsuka
Director

Lewis E. Platt
Director

Nobutake Sato
Director

Officers

James W. Keyes
President and Chief Executive Officer

Gary R. Rose
Executive Vice President, Operations

Bryan F. Smith, Jr.
Executive Vice President, General Counsel and Secretary

Masaaki Asakura
Senior Vice President

Edward W. Moneypenny
Senior Vice President and Chief Financial Officer

David M. Podeschi
Senior Vice President, Merchandising

Cynthia L. Davis
Vice President, Southwest Division

Joseph M. DePinto
Vice President, Operations

Frank S. Gambina
Vice President, Franchising

John W. Harris
Vice President, Florida Division

David Huey
Vice President, North Pacific Division

Sylvester J. Johnson
Vice President and Controller

Gary C. Lockhart
Vice President, Gasoline Supply

P. Keith Morrow
Vice President and Chief Information Officer

Stanley W. Reynolds
Vice President and Treasurer

Jeffrey A. Schenck
Vice President, Great Lakes Division

Nancy A. Smith
Vice President, Field Merchandising

Joseph M. Strong
Vice President, Chesapeake Division

Donald E. Thomas
Vice President, Central Division

Rick D. Updyke
Vice President, Business Development

Shareholder Information

Stock Exchange Listing

7-Eleven's common stock is listed on the New York Stock Exchange. The symbol is "SE."

Shareholder Information

Questions about stock ownership, changes of address, etc. should be directed to 7-Eleven's transfer agent and registrar:

Computershare Investor Services, LLC
2 North La Salle
Chicago, IL 60602
(312) 360-5464 or toll free (877) 360-5464
www.computershare.com

The Computershare Investor Services Program features dividend reinvestment, optional cash investments, automatic stock purchase and safekeeping of stock certificates.

Investor Information

Securities analysts, portfolio managers and representatives of financial institutions may contact:
7-Eleven, Inc.
2711 North Haskell Avenue
Dallas, TX 75204-2906
(214) 828-7333
Email:invest@7-11.com

Annual Meeting

The annual meeting of shareholders will be held at 9:30 a.m. central time, Wednesday, April 21, 2004, at:

7-Eleven, Inc.
Cityplace Conference Center
2711 North Haskell Avenue
Dallas, TX 75204-2906

Meeting notice and proxy materials are mailed in advance to shareholders of record.

Corporate Headquarters

7-Eleven, Inc.
2711 North Haskell Ave.
Dallas, Texas 75204-2906
(214) 828-7011

Other Information

Requests for the Form 10-K for the year ended December 31, 2003, and quarterly financial information should be addressed to the Investor Relations department at the above address, by telephone at (214) 828-7333, or by email at invest@7-11.com. Investors may receive information regularly from the Company via e-mail or by fax by requesting to be included on the Company's mailing list.

Web Address

www.7-Eleven.com

Independent Auditors

PricewaterhouseCoopers LLP
Dallas, Texas

Common Stock

The table below shows the price range for the Company's common stock during each quarter of 2002 and 2003 and the closing price on the last trading day of each quarter.

Quarters	High	Low	Close
2003			
First	$ 8.30	$6.50	$ 6.96
Second	10.99	6.99	10.55
Third	14.63	10.20	13.73
Fourth	16.75	13.94	16.05
2002			
First	$12.20	$8.90	$11.15
Second	10.92	6.80	8.05
Third	9.48	6.65	8.57
Fourth	8.70	7.41	7.50

7-Eleven Around the World

(As of December 31, 2003)

7-Eleven, Inc. State/Province	7-Eleven Stores
United States	
Arizona	83
California	1,213
Colorado	232
Connecticut	52
Delaware	26
District of Columbia	21
Florida	543
Idaho	11
Illinois	181
Indiana	33
Kansas	12
Maine	13
Maryland	302
Massachusetts	110
Michigan	131
Missouri	74
Nevada	197
New Hampshire	27
New Jersey	215
New York	256
North Carolina	7
Ohio	13
Oregon	128
Pennsylvania	168
Rhode Island	18
Texas	275
Utah	103
Vermont	4
Virginia	613
Washington	210
West Virginia	22
Subtotal	5,293
Canada	
Alberta	147
British Columbia	148
Manitoba	49
Ontario	104
Saskatchewan	43
Subtotal	491
TOTAL	5,784
United States and Canada	
Franchised	3,338
Company-operated	2,446
TOTAL	5,784

Liscenced or Operated by Affiliates	7-Eleven Stores
Australia	308
China	150
Denmark	44
Guam	8
Hong Kong	484
Japan	10,080
Malaysia	300
Mexico	421
Norway	75
Philippines	195
Puerto Rico	13
Singapore	206
South Korea	1,277
Sweden	74
Taiwan	3,470
Thailand	2,397
Turkey	21
United States	489
Subtotal	20,012
7-ELEVEN WORLDWIDE	25,796